CLERK'S COPY.

TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1947

No. 227

COMMISSIONER OF INTERNAL REVENUE,
PETITIONER

vs.

JOSEPH SUNNEN

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

PETITION FOR CERTIORARI FILED JULY 28, 1947
CERTIORARI GRANTED OCTOBER 13, 1947

United States Circuit Court of Appeals
EIGHTH CIRCUIT.

No. 13,425

TAX REVIEW.

JOSEPH SUNNEN, PETITIONER,
vs.
COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

No. 13,426

TAX REIVEW.

COMMISSIONER OF INTERNAL REVENUE,
PETITIONER,
vs.
JOSEPH SUNNEN, RESPONDENT.

ON PETITIONS TO REVIEW DECISION OF THE TAX COURT OF THE UNITED STATES.

FILED AUGUST 29, 1946.

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[fol. 1] Docket Entries.

Joseph Sumnen, Petitioner,
Docket No. 6089. vs.
Commissioner Of Internal Revenue, Respondent.

Appearances:

For Taxpayer: C. Powell Fordyce.

For Comm'r.: T. W. Elliott, R. C. Hormberg.

Transferred to Judge Leech 1/28/46.

1944

Sept. 21—Petition received and filed. Taxpayer notified. Fee paid.

Sept. 22—Copy of petition served on General Counsel.

Nov. 14—Answer filed by General Counsel.

Nov. 14—Request for hearing in St. Louis, Mo. filed by General Counsel.

Nov. 22—Notice issued placing proceedings on St. Louis, Mo. calendar.
Service of answer and request made.

Dec. 29—Reply to answer filed by taxpayer. Copy served.

1945

Feb. 3—Hearing set March 19, 1945, St. Louis, Mo.

Mar. 19—Hearing had before Judge Van Fossan on merits. Stipulation of facts filed (Taken under submission.) Briefs due May 3, 1945. Reply briefs due May 18, 1945.

Mar. 29—Transcript of hearing 3/19/45 filed.

Apr. 30—Brief filed by taxpayer.

May 3—Motion for extension to June 2, 1945 to file brief filed by General Counsel. 5/4/45 Granted.

May 10—Motion for extension to July 2, 1945 to file reply brief filed by taxpayer. 5/10/45 Granted.

May 24—Brief filed by General Counsel. Copy served 5/25/45.

May 25—Copy of brief served on General Counsel.

Jun. 25—Reply brief filed by taxpayer. Copy served.

1946

Mar. 11—Findings of fact and opinion rendered, Judge Leech. Decision will be entered under Rule 50. Copy served 3/11/46.

Mar. 3—Agreed, computation of deficiency filed by General Counsel.

May 8—Decision entered, Judge Black, Div. 15.

Jul. 30—Petition for review by U. S. Circuit Court of Appeals for the Eighth Circuit, and Statement of Points filed by taxpayer.

Jul. 30—Notice of filing petition for review sent to J. P. Wenchel, with statement of points and proof of service filed.

Aug. 6—Petition for review by U. S. Circuit Court of Appeals for the Eighth Circuit filed by General Counsel.

Aug. 6—Notice of filing petition for review sent to C. Powell Fordyce filed.

Aug. 6—Joint praecipe for transcript on review filed with proof of service thereon.

Aug. 12—Proof of service of General Counsel's petition for review filed.

Aug. 16—Proof of service of petition for review on Mr. Sunnen filed.

[fol. 2] (Petition of Joseph Sunnen.)

(Received and Filed September 21, 1944, The Tax Court of the United States.)

The Tax Court Of The United States

Joseph Sunnen, Petitioner,
Docket No. 6089. vs.
Commissioner Of Internal Revenue, Respondent.

The above-named petitioner hereby petitions for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau symbols: IRA: 90D: SL. File No. 014127), dated June 28, 1944, and as a basis of his proceeding alleges as follows:

A. The petitioner is an individual residing at 400 South Warson Road, Clayton, Missouri. The income tax returns of the petitioner for the calendar years here involved were duly filed by him with the Collector of Internal Revenue for the First District of Missouri at St. Louis, Missouri.

B. The notice of deficiency (a copy of which is attached and marked Exhibit "A") was mailed to the petitioner on or about, but not before, June 28, 1944.

[fol. 3] C. The taxes in controversy are deficiency income taxes, alleged by respondent to be owed by petitioner for the calendar years, and in the amounts set forth below, to-wit:

Calendar Year	Deficiency Assessment
1937	$ 5,067.11
1938	4,533.01
1939	7,994.77
1940	29,540.50
1941	103,227.18
Total	$ 150,362.57

D. The determination of said deficiency taxes set forth in said notice of deficiency is based upon the following errors:

(1) The respondent erred in determining that petitioner is taxable for the calendar year of 1937 upon royalties of $20,400.03 which Sunnen Products Company, a Mis-

souri corporation, having its principal place of business in St. Louis County, Missouri, (hereinafter for convenience referred to as "said company") paid in said year to Cornelia Sunnen, petitioner's wife; and respondent also erred in failing to determine that the assessment of any deficiency by him against petitioner for said year was, prior to such assessment, barred by the statute of limitations set forth in Sec. 275(a) Revenue Act of 1936.

(2) The respondent erred in determining that petitioner is taxable for the calendar year of 1938 upon royalties of $17,318.80 which said company in said year paid to petitioner's said wife; and respondent also erred in failing to [fol. 4] determine that the assessment of any deficiency by him against the petitioner for said year was, prior to such assessment, barred by the statute of limitations set forth in Sec. 275(a) of the Revenue Act of 1938.

(3) The respondent erred in determining that petitioner is taxable for the calendar year of 1939 upon royalties of $25,243.77, which said company in said year paid to petitioner's said wife.

(4) The respondent erred in determining that petitioner is taxable for the calendar year of 1940 upon royalties of $50,492.50, which said company in said year paid to petitioner's said wife.

(5) The respondent erred in determining that petitioner is taxable for the calendar year of 1941 upon royalties of $149,002.78 which said company paid in said year to petitioner's said wife.

(6) The respondent erred in failing to find that the decision of the Board of Tax Appeals in the proceeding entitled "Joseph Sunnen vs. Commissioner of Internal Revenue", Docket Nos. 64,117, 69,526, and 74,077, bars him from now determining that petitioner owes income taxes for any of the above-mentioned years on any of the aforesaid royalties so paid by said company to his said wife.

[fol. 5] E. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(1) As to the alleged 1937 deficiency, the petitioner states as follows:

Par. A. Prior to November 17, 1927 petitioner had invented a device known as a "Cylinder-Grinder" or as a "Honing Device for Cylinders", said device being hereinafter for convenience referred to as a Cylinder-Grinder. On said date petitioner filed an application for a patent on said invention, said application being numbered 233,788. Said application was allowed on December 4, 1934, and U. S. Patent No. 1, 982,836 was issued to petitioner. On January 10, 1928 petitioner and said company (Sunnen Products Company) entered into a contract whereby petitioner licensed said company, for a period of ten years from said date, to manufacture and sell said device for a royalty of ten percent of the gross sales price thereof. On January 8, 1929 petitioner executed the following assignment on the back of said contract:

"For value received, I hereby sell, assign, and transfer to Mrs. Cornelia Sunnen all of my rights, title and interest in and to the royalties which shall accrue hereafter to me on the within contract."

On the back of said contract there also appears the following notation; "Royalty lease. Standard Cylinder—Grinder assigned to Cornelia Sunnen January 8, 1929." Under date [fol. 6] of January 15, 1929 the petitioner addressed and signed a letter to the company stating as follows:

"Confirming verbal notice given you at the annual stockholder's meeting held at the company's office on January 8, 1929, I have for value received assigned to Cornelia Sunnen, all of my rights, title and interest in the royalty contract covering 'Cylinder-Grinders', covered by Letters Patent No. 233,788, said contract dated the 10th day of January, 1928."

Further confirming the aforesaid assignment the petitioner on or about December 21, 1931 delivered to said company a written instrument executed by him which stated that the Commissioner of Internal Revenue had raised some question as to the sufficiency of the foregoing assignment; that the petitioner in all respects confirmed said foregoing assignment; that the petitioner assigned, set over, and delivered to Cornelia Sunnen all of the petitioner's right, title, and interest in and to said royalty contract of January 10, 1928; and that the royalties accruing under said

contract are the exclusive property of Cornelia Sunnen, should be paid to her, and that she should have the sole right to collect and retain the same. In the aforesaid proceeding entitled Joseph Sunnen vs. Commissioner of Internal Revenue, Docket Nos. 64,117, 69,526, and 74,077, the United States Board of Tax Appeals on June 29, 1935 entered its decision holding that the petitioner was not taxable for 1929, 1930, and 1931 upon the royalties paid to his wife by said company in said years, under and pursuant to the above-mentioned royalty contract and assignments. The royalties paid by said company to petitioner's wife in [fol. 7] 1937, which amounted to $4,881.35, were likewise paid to her under and pursuant to the same contract and assignments involved in the above-mentioned proceedings before the United States Board of Tax Appeals. However, the respondent has, in this proceeding, ignored said prior decision of the United States Board of Tax Appeals, and has determined that these royalties are taxable to the petitioner as a part of his income for 1937.

Par. B. Prior to December 4, 1931 the petitioner had invented a device known as a "Bushing-Grinder" or as a "Pinhole Grinder", said device being hereinafter for convenience referred to as a Bushing Grinder. On said date petitioner filed an application for a patent on said invention, said application being numbered 578,923. Said application was allowed on June 13, 1933, and United States Patent No. 1,913,689 was issued to petitioner. On December 5, 1931 petitioner and said company entered into a contract which was substantially similar in all material respects to the royalty agreement mentioned in paragraph 1A above, and which provided that the petitioner licensed said company, for a period of ten years from said date, to manufacture and sell said device for a royalty of ten percent. of the gross sales price thereof. Also on December 5, 1931 the petitioner executed and delivered to said company a written instrument which provided that he assigned to his said [fol. 8] wife all of his right, title, and interest in and to the aforesaid Bushing Grinder royalty contract, together with the sole right to collect and receive any royalties due under said royalty contract, the same to be collected and received by her as her sole and exclusive property. The royalties paid by said company to petitioner's wife in 1937,

under the aforesaid Bushing Grinder royalty contract and assignment, amounted to $15,518.68. Respondent has determined that these royalties are taxable to petitioner as a part of his income for 1937.

Par. C. The petitioner alleges that none of said royalties were taxable to him as a part of his income for 1937, and that the statute of limitations set forth in Sec. 275(a) of the Revenue Act of 1936 had expired prior to the assessment on June 28, 1944 by the respondent of said deficiency of $5,067.11 for said year against the peitioner.

(2) As to the alleged 1938 deficiency, petitioner states as follows:

Par. A. On January 10, 1938, the date of the expiration of said Cylinder-Grinder royalty contract mentioned in paragraph 1A above, the petitioner and said company executed an agreement renewing said contract upon exactly the same terms and conditions as contained in said original contract, except that the period covered by such renewal contract extended from January 10, 1938 to December 4, 1951 (the date of the expiration of the patent involved). [fol. 9] Also on January 10, 1938 the petitioner executed and delivered to said company a written instrument which provided that he assigned all of his right, title, and interest in and to said renewal agreement to his wife, together with the sole right to collect and receive any royalties theretofore or thereafter accruing thereunder, said royalties to be the sole and exclusive property of Cornelia Sunnen. Under and pursuant to said renewal agreement and assignment, the company paid royalties to the petitioner's wife for 1938 amounting to $3,529.21.

Par. B. Under and pursuant to the Bushing-Grinder royalty agreement and assignment mentioned in paragraph 1B above, said company in 1938 paid to petitioner's said wife royalties amounting to $13,789.59.

Par. C. Respondent has determined that all of said Cylinder-Grinder and Bushing-Grinder royalties are taxable to the petitioner as a part of his income for 1938.

Par. D. Petitioner alleges that none of said royalties are taxable to him as a part of his income for 1938, and that the statute of limitations set forth in Sec. 275(a) of the

Revenue Act of 1938 had expired prior to the assessment on June 28, 1944 by the respondent of said deficiency of $4,533.01 for said year against the petitioner.

[fol. 10] (3) As to the alleged 1939 deficiency, petitioner states as follows:

Par. A. Pursuant to the renewal Cylinder-Grinder royalty agreement and assignment mentioned in paragraph 2A above, said company in 1939 paid to petitioner's said wife royalties amounting to $3,713.83.

Par. B. Pursuant to the Bushing-Grinder royalty agreement and assignment mentioned in paragraph 1B above, said company in 1939 paid to petitioner's said wife royalties amounting to $15,780.50.

Par. C. Prior to May 22, 1939 petitioner had invented a device known as a "Crankshaft Grinder". On said date petitioner filed an application for a patent on said device, said application being numbered 275092. Said application was allowed on May 6, 1941, and U. S. Patent No. 2,240,527. was issued to petitioner. In addition, on May 22, 1939 petitioner had invented another device also known as a Crankshaft Grinder, and was in the course of preparing an application for a patent thereon (said application being filed on December 29, 1939, being numbered 311669, and being allowed on January 26, 1943 when Patent No. 2,309,615 was issued to petitioner's said wife as assignee of petitioner). On June 20, 1939 petitioner and said company entered into a contract which was substantially similar to the other royalty contracts mentioned above, and which provided that petitioner licensed said company, for [fol. 11] a period of ten years from said date, to manufacture and sell both of said devices for a royalty of ten percent. of the gross sales price thereof. Moreover, on June 20, 1939 petitioner executed and delivered to said company a written instrument providing that he assigned to his said wife all of his right, title, and interest in and to the aforesaid royalty contract, covering both of said Crankshaft Grinders, together with the sole right to collect and receive all royalties due under said royalty contract, the same to be collected and received by her as her sole and exclusive property. The royalties paid by said company to petitioner's wife in 1939, under the aforesaid royalty contract and assignment amounted to $5,749.44.

Par. D. Respondent has determined that all of said royalties are taxable to the petitioner as a part of his income for 1939.

Par. E. Petitioner alleges that none of said royalties are taxable to him as a part of his income for 1939.

(4) As to the alleged 1940 deficiency petitioner states as follows:

Par. A. Pursuant to the renewal Cylinder-Grinder royalty agreement and assignment metioned in paragraph 2A above, said company in 1940 paid to petitioner's said wife royalties amounting to $4,951.73.

[fol. 12] Par. B. Pursuant to the Bushing-Grinder royalty agreement and assignment mentioned in paragraph 1B above, said company in 1940 paid to petitioner's said wife royalties amounting to $23,259.10.

Par. C. Pursuant to the Crankshaft Grinder royalty agreement and assignment mentioned in paragraph 3C above, said company in 1940 paid to petitioner's wife royalties amounting to $22,281.67.

Par. D. Respondent has determined that all of said royalties are taxable to petitioner as a part of his income for 1940.

Par. E. Petitioner alleges that none of said royalties are taxable to him as a part of his income for 1940.

(5) As to the alleged 1941 deficiency, petitioner states as follows:

Par. A. Pursuant to the renewal Cylinder-Grinder royalty agreement and assignment mentioned in paragraph 2A above, said company in 1941 paid to petitioner's said wife royalties amounting to $6,821.97.

Par. B. Pursuant to the Bushing-Grinder royalty agreement and assignment mentioned in paragraph 1B above, said company in 1941 paid to petitioner's said wife royalties amounting to $123,565.38.

[fol. 13] Par. C. Pursuant to the Crankshaft Grinder royalty agreement and assignment mentioned in paragraph 3C above, said company in 1941 paid to petitioner's said wife royalties amounting to $18,615.43.

Par. D. Respondent has determined that all of said royalties are taxable to petitioner as part of his income for 1941.

Par. E. Petitioner alleges that none of said royalties are taxable to him as a part of his income for 1941.

Wherefore, the petitioner prays that this Court may hear this proceeding and determine that there are no deficiency income taxes due from the petitioner for the calendar years of 1937, 1938, 1939, 1940, and 1941.

C. POWELL FORDYCE,
Counsel for Petitioner.
506 Olive Street,
St. Louis 1, Missouri.

State Of Missouri,
County Of St. Louis—ss.:

JOSEPH SUNNEN, being duly sworn, says that he is the petitioner above named; that he has read the foregoing [fol. 14] petition, and is familiar with the statements contained therein, and that the statements contained therein are true.

JOSEPH SUNNEN,

Subscribed and sworn to before me this 16th day of September, 1944.

(Seal)

LAURA M. ROBBINS,
Notary Public, St. Louis
County, Missouri.

My commission expires June 26, 1946.

[fol. 15] Exhibit "A"

Treasury Department
Internal Revenue Service

St. Louis, Missouri
June 28, 1944

Office of
Internal Revenue Agent in Charge
St. Louis Division
1767 Railway Exchange Building,

File #014127

IRA:90D:SL

Mr. Joseph Sunnen
400 So. Warson Road,
Clayton, Missouri

Dear Mr. Sunnen:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1937 to December 31, 1941, inclusive, discloses a deficiency of $150,362.57 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, St. Louis, Missouri, for the attention of EPS:AK. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest

period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

JOSEPH D. NUNAN, JR.,
Commissioner,
By N. B. Eshleman
Internal Revenue Agent in Charge.

Enclosures:
Statement
Form of waiver

[fol. 16] Statement.

IRA:90D:SL

Joseph Sunnen
400 So. Warson Road,
Clayton, Missouri

Tax Liability for the Taxable Years Ended December 31, 1937, December 31, 1938, December 31, 1939, December 31, 1940, and December 31, 1941.

	Income Tax		
	Liability	Assessed	Deficiency
1937	$ 7,793.58	2,726.47	5,067.11
1938	8,286.53	3,753.52	4,533.01
1939	13,258.94	5,264.17	7,994.77
1940	43,145.34	13,604.84	29,540.50
1941	130,576.30	27,349.12	103,227.18
Totals	$203,060.69	52,698.12	150,362.57

In making this determination of your income tax liability, careful consideration has been given to the reports of examination dated September 14, 1938, February 17, 1940, April 17, 1941, September 8, 1942, October 8, 1942 and February 26, 1943; to your protests dated November 30, 1942, December 11, 1942, and April 1, 1943; and to the statements made at the conferences held on January 15, 1943, April 8, 1943, and May 23, 1944.

A copy of this letter and statement has been mailed to your representative, Mr. C. Powell Fordyce, 506 Olive Street, St. Louis, Missouri in accordance with the authority contained in the power of attorney executed by you.

[fol. 17] Adjustments to Net Income

1937

Net income as disclosed by return		$ 30,616.03
Unallowable deductions and additional income:		
(a) Royalties	$20,400.03	
(b) Interest paid	1,716.64	
(c) Taxes	2,459.32	
(d) Expense to obtain mortgage	35.53	24,611.54
Total		$ 55,227.57
Nontaxable income and additional deductions:		
(e) Rental income	$ 7,008.71	
(f) Social security tax	87.98	7,096.69
Net income adjusted		$48,130.88

Explanation of Adjustments
1937

(a) Distributions made by Sunnen Products Co. to your wife, Cornelia Sunnen, in the form of royalties under license agreements with you, have been included in your gross income for the year 1937 in the amount of $20,400.03, in accordance with the provisions of section 22(a) of the Revenue Act of 1936.

(b), (c), (d), (e) and (f): These adjustments have been previously agreed to by you and the resulting overassessment has been scheduled.

Computation of Tax

1937

Net income adjusted		$ 48,130.88
Less:		
Personal exemption	$ 2,500.00	
Credit for dependents	1,600.00	4,100.00
Balance (surtax net income)		$ 44,030.88
Less:		
Earned income credit		1,400.00
Net income subject to normal tax		$ 42,630.88
[fol. 18] Normal tax at 4% on $42,630.88		$ 1,705.24
Surtax on $44,030.88		6,088.34
Correct income tax liability		$ 7,793.58
Income tax assessed:		
Original, Account No. 202294	$ 3,342.68	
Additional, Account No. 510142, Nov. 10, 1938 list	761.15	
Total assessed	$ 4,103.83	

Less:		
Previous allowance June 11, 1941	1,377.36	
Net assessment		2,726.47
Deficiency of income tax		$ 5,067.11

Adjustments to Net Income
1938

Net income as disclosed by return		$ 36,787.82
Unallowable deductions and additional income:		
(a) Royalties	$ 17,318.80	
(b) Interest paid	2,515.82	
(c) Taxes	316.99	20,151.61
Total		$56,939.43
Nontaxable income and additional deductions:		
(d) Rental income		7,218.35
Net income adjusted		$ 49,721.08

[fol. 19] Explanation of Adjustments
1938

(a) Distributions made by Sunnen Products Co. to your wife, Cornelia Sunnen, in the form of royalties under license agreements with you, have been included in your gross income for the year 1938 in the amount of $17,318.80, in accordance with the provisions of Section 22(a) of the Revenue Act of 1938.

(b), (c), and (d): These adjustments have been previously agreed to by you and the resulting overassessments resulting therefrom have been scheduled.

Computation of Tax
1938

Net income adjusted		$ 49,721.08
Less:		
Personal exemption	$ 2,500.00	
Credit for dependents	1,600.00	4,100.00
Balance (surtax net income)		$ 45,621.08
Less:		
Earned income credit		1,400.00
Net income subject to normal tax		$ 44,221.08
Normal tax at 4% on $44,221.08		$ 1,768.84
Surtax on $45,621.08		6,517.69
Correct income tax liability		$ 8,286.53
Income tax assessed:		
Original, Account No. 201370	$ 4,765.31	
Total assessed	$ 4,765.31	

Less:		
Previous allowance 4-17-40	$ 14.36	
Previous allowance 6-11-41	997.43	1,011.79
Net assessment		3,753.52
Deficiency of income tax		$ 4,533.01

[fol. 20] Adjustments to Net Income

1939

Net income as disclosed by return		$ 42,229.35
Unallowable deductions and additional income:		
(a) Royalties	$ 25,243.77	
(b) Interest paid	2,995.01	
(c) Taxes	500.11	28,738.89
Total		$70,968.24
Nontaxable income and additional deduction:		
(d) Rental income		6,983.78
Net income adjusted		$ 63,984.46

Explanation of Adjustments
1939

(a) Distributions made by Sunnen Products Co. to your wife, Cornelia Sunnen, in the form of royalties under license agreements with you, have been included in your gross income for the year 1939 in the amount of $25,243.77, in accordance with the provisions of Section 22(a) of the Internal Revenue Code.

(b), (c) and (d): These adjustments have been previously agreed to by you and the resulting overassessment has been scheduled.

Computation of Tax

1939

Net Income adjusted		$ 63,984.46
Less:		
Personal exemption	$ 2,500.00	
Credit for dependents	1,600.00	4,100.00
Balance (surtax net income)		$ 59,884.46
Less:		
Earned income credit		1,400.00
Net income subject to normal tax		$ 58,484.46
Normal tax at 4% on $58,484.46		$ 2,339.38
Surtax on $59,884.46		10,919.56
Correct income tax liability	Forward	$ 13,258.94

[fol. 21] Correct income tax liability	Brought forward	$ 13,258.94
Income tax assessed:		
Original, Account No. 201395	$ 6,140.21	
Less:		
Previous allowance 6-11-41	876.04	
Net assessment		5,264.17
Deficiency of income tax		$ 7,994.77

Adjustments to Net Income
1940

Net income as disclosed by amended return filed May 25, 1942	$ 48,846.92
Unallowable deduction and additional income:	
(a) Royalties	50,492.50
Net income adjusted	$ 99,339.42

Explanation of Adjustments
1940

(a) Distributions made by Sunnen Products Co. to your wife, Cornelia Sunnen, in the form of royalties under license agreements with you, have been included in your gross income for the year 1940 in the amount of $50,492.50, in accordance with the provisions of Section 22(a) of the Internal Revenue Code.

[fol. 22] Computation of Tax
1940

Net income adjusted	$ 99,339.42
Less:	
Credit for dependents	1,600.00
Balance (surtax net income)	$ 97,739.42
Less:	
Earned income credit	1,400.00
Net income subject to normal tax	$ 96,339.42
Normal tax at 4% on $96,339.42	$ 3,853.58
Surtax on $97,739.42	35,514.08
Total tax	$ 39,367.66
Defense tax (10% of $39,367.66)	3,936.77
Total income and defense taxes	$ 43,304.43

Less:		
Income tax paid to a foreign country or U. S. Possession		159.09
Correct income and defense tax liability		$ 43,145.34
Income and defense taxes assessed:		
Original, Account No. 203792	$ 12,240.99	
Additional, Account No. 300113, May, 1942 list	1,363.85	13,604.84
Deficiency of income and defense taxes		$ 29,540.50

[fol. 23]

Adjustments to Net Income
1941

Net income as disclosed by return		$ 60,570.28
Unallowable deductions and additional income:		
(a) Royalties	$149,002.72	
(b) Long term loss	175.00	
(c) Other income	638.75	
(d) Other deductions	665.44	150,481.97
Net income adjusted		$211,052.25

Explanation of Adjustments
1941

(a) Distributions made by Sunnen Products Co. to your wife, Cornelia Sunnen, in the form of royalties under license agreements with you, have been included in your gross income for the year 1941 in the amount of $149,002.78, in accordance with the provisions of Section 22(a) of the Internal Revenue Code.

(b) On your return you deducted from gross income $1,738.90 for net long term loss from sale of capital assets, whereas the information on file discloses the correct amount to be $1,563.90. Income is, therefore, increased by $175.00.

(c) The Sunnen Products Co. paid $1,277.50 for cost of audit to determine property rights between yourself and your wife of rental property, and one-half thereof or $638.75 was paid for you and constitutes taxable income to you.

(d) On line 16 of your return you deducted $665.44 as other deductions for a portion of the cost of an audit to determine property rights which is not an allowable deduction. Income is, therefore, increased by $665.44.

[fol. 24] Computation of Tax

1941

Net income adjusted	$ 211,052.25
Plus:	
Net long term loss	1,563.90
Total	$ 212,616.15
Less:	
Credit for dependents	1,600.00
Balance (surtax net income)	$ 211,016.15
Less:	
Earned income credit	1,400.00
Net income subject to normal tax	$ 209,616.15
Normal tax at 4% on $209,616.15	$ 8,384.65
Surtax on $211,016.15	122,660.82
Total tax	$ 131,045.47
Minus:	
30% of long-term loss of $1,563.90	469.17
Correct income tax liability	$ 130,576.30
Income tax assessed:	
Original, Account No. 325765	27,349.12
Deficiency of income tax	$ 103,227.18

WNG:AK

[fol. 25] (Answer of Commisioner of Internal Revenue.)

(Received and Filed November 14, 1944, The Tax Court of the United States.)

Comes now the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed herein, admits, denies, and alleges as follows:

A. Admits that petitioner is an individual residing at 400 South Warson Road, Clayton, Missouri, and that the income tax returns of the petitioner for the calendar years here involved were filed by him with the Collector of Internal Revenue for the First District of Missouri at St. Louis, Missouri, but denies the remaining allegation of paragraph A of the petition.

B, C. Admits the allegations contained in paragraphs B and C of the petition.

D. (1) Denies that the Commissioner erred as alleged in subparapgraph (1) of paragraph D of the petition.

(2) Denies that the Commissioner erred as alleged in subparagraph D of the petition.

[fol. 26] (3) Denies that the Commissioner erred as alleged in subparagraph (3) of paragraph D of the petition.

(4) Denies that the Commissioner erred as alleged in subparagraph (4) of paragraph D of the petition.

(5) Denies that the Commissioner erred as alleged in subparagraph (5) of paragraph D of the petition.

(6) Denies that the Commissioner erred as alleged in subparagraph (6) of paragraph D of the petition.

E. (1) Par. A. Admits that petitioner invented a device known as a "cylinder grinder," that he secured a patent covering said device, that on January 10, 1928, petitioner and Sunnen Products Company entered into a contract whereby petitioner licensed said company for a period of ten years from said date to manufacture and sell said device for a royalty of 10 percent of the gross sales price thereof; that under date of June 29, 1935, the Board of Tax Appeals promulgated an opinion in the case of Joseph Sunnen, Docket Nos. 64117, 69526, and 74077, holding that the petitioner therein was not taxable on certain royalties; and that respondent has determined that petitioner is taxable on certain royalties for the year 1937; but denies the remaining allegations contained in subparagraph (1) A of paragraph E of the petition.

Par. B. Admits that on December 5, 1931, petitioner entered into a license agreement with Sunnen Products Company for the manufacture and sale of a device known as a "pin-hole grinder," with respect to which petitioner had made application for a patent; that under the terms [fol. 27] of such agreement petitioner licensed said company for a period of ten years from said date to manufacture and sell said device for a royalty of ten percent of the gross sales price thereof; and that respondent has determined that petitioner is taxable on certain royalties for the year 1937, but denies the remaining allegations contained in subparagraph (1) B of paragraph E of the petition.

Par. C. Admits that the statute of limitations set forth in section 275(a) of the Revenue Act of 1936 expired prior to June 28, 1944, but denies the remaining allegations set forth in subparagraph (1) C of paragraph E of the petition.

(2) Par. A. Admits that in 1938 petitioner and Sunnen Products Company entered into a royalty contract with respect to the "cylinder grinder", but denies the remaining allegations contained in subparagraph (2) A of paragraph E of the petition.

Par. B. Denies the allegations set forth in subparagraph (2) B of paragraph E of the petition.

Par. C. Admits the allegations contained in subparagraph (2) C of paragraph E of the petition.

Par. D. Admits that the statute of limitations set forth in section 275(a) of the Revenue Act of 1938 expired prior to June 28, 1944, but denies the remaining allegations contained in subparagraph (2) of paragraph E of the petition.

(3) Par. A. Denies the allegations set forth in subparagraph (3) A of paragraph E of the petition.

[fol. 28] Par. B. Denies the allegations contained in subparagraph (3) B of paragraph E of the petition.

Par. C. Admits that in 1939 petitioner entered into a license agreement with Sunnen Products Company for the manufacture and sale of a device known as a "crankshaft grinder", and that under the terms of such agreement he was to receive a royalty measured by ten percent of the gross sales price, but denies the remaining allegations of subparagraph (3) C of paragraph E of the petition.

Par. D. Admits the allegations set forth in subparagraph (3) D of paragraph E of the petition.

Par. E. Denies the allegations contained in subparagraph (3) E of paragraph E of the petition.

(4) Par. A. Denies the allegations contained in subparagraph (4) A of paragraph E of the petition.

Par. B. Denies the allegations contained in subparagraph (4) B of paragraph E of the petition.

Par. C. Denies the allegations contained in subparagraph (4) C of paragraph E of the petition.

Par. D. Admits the allegations contained in subparagraph (4) D of paragraph E of the petition.

Par. E. Denies the allegations contained in subparagraph (4) E of paragraph E of the petition.

(5) Par. A. Denies the allegations contained in subparagraph (5) A of paragraph E of the petition.

Par. B. Denies the allegations contained in subparagraph (5) B of paragraph E of the petition.

[fol. 29] Par. C. Denies the allegations contained in subparagraph (5) C of paragraph E of the petition.

Par. D. Admits the allegations contained in subparagraph (5) D of paragraph E of the petition.

Par. E. Denies the allegations contained in subparagraph (5) E of paragraph E of the petition.

F. Denies generally and specifically each and every allegation contained in the petition not hereinbefore specifically admitted, qualified, or denied.

G. Further answering the petition, for an affirmative defense, respondent alleges that the five-year period of limitation is applicable under section 275(c) of the Revenue Acts of 1936 and 1938 for assessment and collection of the income tax deficiencies determined by the Commissioner in the amounts of $5,067.11 for 1937, and $4,533.01 for 1938, as set forth in his notice of deficiency, copy of which is attached to the petition as Exhibit "A". In support of the Commissioner's determination set forth in said notice of deficiency (which notice is hereby adopted and incorporated herein by reference), respondent, by such adoption and incorporation, affirmatively alleges and relies upon all the facts, statements, and findings therein, and in addition thereto alleges and relies upon the following facts:

(1) For the taxable year 1937 petitioner filed with the Collector of Internal Revenue for the First District of Mis-

souri an individual income tax return on March 16, 1938, wherein he reported gross income in the total amount of $38,992.40.

[fol. 30] (2) In truth and in fact, the gross income of petitioner for the taxable year 1937 totaled $59,392.43 ($38,992.40 plus $20,400.03).

(3) Petitioner improperly omitted from the gross income stated in his income tax return for 1937 an amount in excess of 25 percent of his total gross income for such year, and the income tax deficiency determined by the Commissioner for 1937 may have been assessed and collected within five years after the return was filed, under section 275(c) of the Revenue Act of 1936.

(4) In pursuance of the provisions of the existing internal revenue laws, petitioner duly executed on February 27, 1943, a "Consent Fixing Period of Limitation upon Assessment of Income and Profits Tax under Section 275(c) of the Revenue Act of 1936," covering the taxable year 1937, to June 30, 1944, and on May 9, 1944, petitioner duly executed a "Consent Fixing Period of Limitation upon Assessment of Income and Profits Tax under Section 275(c) of the Revenue Act of 1936," covering the taxable year 1937, to June 30, 1945.

(5) The period of limitation upon assessment and collection of an income tax deficiency for the year 1937 had not expired at the time the Commissioner of Internal Revenue mailed his notice of deficiency to petitioner on June 28, 1944, asserting an income tax deficiency for such year.

(6) For the taxable year 1938 petitioner filed with the Collector of Internal Revenue for the First District of Missouri an individual income tax return on March 15, 1939, [fol. 31] wherein he reported gross income in the total amount of $45,625.36.

(7) In truth and in fact, the gross income of petitioner for the taxable year 1938 totaled $62,944.16 ($45,625.36 plus $17,318.80).

(8) Petitioner improperly omitted from the gross income stated in his income tax return for 1938 an amount in excess of 25 percent of his total gross income for such year, and the income tax deficiency determined by the Commissioner for 1938 may be assessed and collected within five years after the return was filed, under section 275(c) of the Revenue Act of 1938.

(9) In pursuance of the provisions of the existing internal revenue laws, petitioner executed on January 6, 1944, a "Consent Fixing Period of Limitation upon Assessment of Income and Profits Tax under Section 275(c) of the Revenue Act of 1938," covering the taxable year 1938, to June 30, 1945.

(10) The period of limitation upon assessment and collection of an income tax deficiency for the year 1938 had not expired at the time the Commissioner of Internal Revenue mailed his notice of deficiency to petitioner on June 28, 1944, asserting an income tax deficiency for such year.

Wherefore, it is prayed:

(1) That the Tax Court enter its decision that the petitioner improperly omitted from the gross income stated in his income tax returns for 1937 and 1938 amounts in excess of 25 percent of his total gross income for such years; [fol. 32] that for 1937 and 1938 the five-year period of limitation for assessment and collection of income tax deficiencies attaches pursuant to section 275(c) of the Revenue Acts of 1936 and 1938; that the Commissioner's notice of deficiency dated June 28, 1944, was timely mailed to petitioner; and that the assessments of the said income tax deficiencies for the years 1937 and 1938 are not barred.

(2) That the Tax Court redetermine the correct amounts of deficiencies in this proceeding to be equal to the amounts determined by the Commissioner in his deficiency notice dated June 28, 1944, namely, $5,067.11 in income tax for 1937, $4,533.01 in income tax for 1938, $7,994.77 in income tax for 1939, $29,540.50 in income tax for 1940, and $103,227.18 in income tax for 1941.

(3) That the petitioner's appeal be denied and the respondent's determination be approved.

J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue

Of Counsel:
ORRIS BENNETT,
Division Counsel.

LOYAL E. KEIR,
Special Attorney,
Bureau of Internal Revenue.

LEK/mcs 11-9-44

[fol. 33] (Reply of Joseph Sunnen.)

(Received and Filed December 29, 1944, The Tax Court of the United States.)

Comes now Joseph Sunnen, the petitioner above named, by his attorney, C. Powell Fordyce, and for reply to the allegations affirmatively set forth by the respondent in his answer filed herein, admits, denies, and alleges as follows:

G. Admits that the income tax deficiencies determined by the respondent in his notice of deficiency, a copy of which is attached to the petition as Exhibit "A", amount to $5,067.11 for 1937, and $4,533.01 for 1938; but denies that the five year period of limitations, under Section 275 (c) of the Revenue Acts of 1936 and 1938, is applicable for the assessment and collection of said income tax deficiencies for 1937 and 1938.

G. (1) Admits that for the taxable year 1937 petitioner filed with the Collector of Internal Revenue for the First [fol. 34] District of Missouri an individual income tax return wherein he reported gross income of $38,992.40; but denies the remaining allegations contained in subparagraph (1) of paragraph G of respondent's answer.

G. (2) Denies the allegations contained in subparagraph (2) of paragraph G of respondent's answer.

G. (3) Denies the allegations contained in subparagraph (3) of paragraph G of respondent's answer.

G. (4) Denies the allegations contained in subparagraph (4) of paragraph G of respondent's answer.

G. (5) Denies the allegations contained in subparagraph (5) of paragraph G of respondent's answer.

G. (6) Admits the allegations contained in subparagraph (6) of paragraph G of respondent's answer.

G. (7) Denies the allegations contained in subparagraph (7) of paragraph G of respondent's answer.

G. (8) Denies the allegations contained in subparagraph (8) of paragraph G of respondent's answer.

G. (9) Denies the allegations contained in subparagraph (9) of paragraph G of respondent's answer.

G. (10) Denies the allegations contained in subparagraph (10) of paragraph G of respondent's answer.

H. Denies generally and specifically each and every allegation contained in respondent's answer not hereinbefore specifically admitted, qualified, or denied.

[fol. 35] Wherefore, petitioner prays that the affirmative relief requested by the respondent in his answer be denied; and that petitioner be granted the relief requested by him in his said petition.

C. POWELL FORDYCE,
Counsel for Petitioner,
506 Olive Street,
St. Louis 1, Missouri.

Dated: December 27, 1944.

[fol. 36] Stipulation of Facts.

(Filed at Hearing at St. Louis, Mo., on March 19, 1945, The Tax Court of the United States).

It is hereby stipulated and agreed by and between counsel for the respective parties in the above-entitled proceeding, that the following facts are true and may be found as facts by The Tax Court of the United States, subject to the right of either party to introduce evidence of other facts not inconsistent with the facts herein agreed to:

1. Petitioner is an individual whose address is 400 South Warson Road, Clayton, Missouri. Petitioner filed his Federal income tax returns for the calendar years of 1937, 1938, 1939, 1940, and 1941 with the Collector of Internal Revenue, First District, Missouri; and duly paid to said Collector the income taxes shown to be due by said returns.

2. In his aforesaid income tax return for said years the petitioner reported his income upon the cash receipts and disbursements basis.

[fol. 37] 3. Sunnen Products Company, hereinafter referred to for convenience as "the Company", is a Missouri corporation having its principal place of business in St. Louis, Missouri; and during the years here involved was engaged in the business of manufacturing and selling patented grinding machines and other tools. The capital stock of the Sunnen Products Company during the taxable years 1937 to 1941, inclusive, was held as follows:

1780	shares	Joseph Sunnen, President, Petitioner
200	"	Cornelia Sunnen, Petitioner's wife
18	"	W. A. Douglas, Vice-President
1	"	Comptroller
1	"	Production Manager
2000	"	Total shares outstanding

4. During the years mentioned above Cornelia Sunnen was, and is now, the petitioner's wife.

5. On or about November 17, 1927 petitioner filed with the United States Patent Office an application number 233,788 for a patent upon a device invented by him as a Cylinder Grinder, or as a Honing Device for Cylinders, said device being hereinafter for convenience referred to as Cylinder Grinder. Said application was allowed on December 4, 1934, and United States Patent No. 1,982,836 was issued to petitioner, who remained the owner thereof during the aforesaid years of 1937-1941, both inclusive.

[fol. 38] 6. On January 10, 1928 petitioner and the company duly executed a license agreement whereby petitioner licensed the company to manufacture and sell said Cylinder Grinder for a period of ten years, and the com-

pany agreed to pay him a royalty of ten percent of the gross sale price of said devices. A true and correct copy of said agreement is attached hereto as Exhibit 1A. Said agreement is hereinafter referred to as the original Cylinder Grinder License Agreement.

7. On or about January 8, 1929 petitioner signed a statement on the back of said original Cylinder Grinder License Agreement (see Exhibit 1A, p. 2) by which he purported to assign to his wife all royalties which should accrue under said agreement. A statement also appears on the back of said agreement (see Exhibit 1A, p. 2) to the effect that the agreement itself had been assigned to petitioner's wife. On January 15, 1929 petitioner delivered to the company a letter stating that he had assigned to his wife all of his interest in said original Cylinder Grinding License Agreement. A true and correct copy of said letter is attached hereto as Exhibit 2B. On December 21, 1931 petitioner delivered to the company another letter notifying it that he had executed a new assignment to his wife of his interest in said original Cylinder Grinder License Agreement, which confirmed in all respects his previous assignments—a true and correct copy of said letter being attached hereto as Exhibit 3C. In said letter of December 21, 1931 petitioner enclosed a copy of said new [fol. 39] assignment, the executed original copy of said new assignment having been delivered to his said wife. A true and correct copy of said new assignment is attached hereto as Exhibit 4D. The instruments mentioned in this paragraph were construed and considered by the United States Board of Tax Appeals in proceedings entitled Joseph Sunnen vs. Commissioner of Internal Revenue Docket Nos. 64117, 69526, and 74077, which proceedings involved petitioner's liability to pay income taxes on said royalties for the calendar years of 1929, 1930, and 1931. The opinion and decision of the Board of Tax Appeals in the aforesaid proceedings may be considered by the United States Tax Court in this proceeding, to the same extent as if introduced in evidence herein.

8. On or about December 4, 1931, petitioner filed with the United States Patent Office an application numbered 578,923 for a patent upon another device invented by him known as a Pinhole Grinder, or as a Bushing Grinder, said

device being hereinafter for convenience referred to as a Bushing Grinder. Said application was allowed on June 13, 1933, and United States Patent No. 1,913,689 was issued to petitioner, who remained the owner thereof during the years of 1937-1941, both inclusive.

9. On December 5, 1931 petitioner and the company duly executed a license agreement whereby petitioner licensed the company to manufacture and sell said Bushing Grinder for a period of ten years, and the company agreed to pay him a royalty of ten percent upon the gross [fol. 40] sales price of said device. A true and correct copy of said agreement is attached hereto as Exhibit 5E. Said agreement is hereinafter for convenience referred to as said Bushing Grinder License Agreement.

10. On or about December 5, 1931 petitioner delivered to the company a letter notifying it that he had assigned all of his right, title, and interest in said Bushing Grinder License Agreement to his wife—a true and correct copy of said letter being attached hereto as Exhibit 6F. In said letter of December 5, 1931 petitioner enclosed a copy of said assignment, the original assignment being delivered to his wife. A true and correct copy of said assignment is attached hereto as Exhibit 7G.

11. On January 10, 1938 said original Cylinder Grinder License Agreement expired; and petitioner and the company duly executed a renewal license agreement whereby petitioner licensed the company to manufacture and sell said cylinder Grinder until December 4, 1951—the date when said Cylinder Grinder patent expired—, in consideration of the company agreeing to pay him a royalty of ten percent of the gross sales price of said Cylinder Grinder during said period. A true and correct copy of said renewal agreement is attached hereto as Exhibit 8H. Said renewal agreement is hereinafter referred to as the Renewal Cylinder Grinder License Agreement.

[fol. 41] 12. On or about January 10, 1938 petitioner delivered to the company a letter notifying them that he had assigned all of his right, title, and interest in said renewal Cylinder Grinder License Agreement to his wife—a true and correct copy of said letter being attached hereto as Exhibit 9I. In said letter of January 10, 1938, petitioner

enclosed a copy of said assignment, the original assignment being delivered to petitioner's wife. A true and correct copy of said assignment is attached hereto as Exhibit 10J.

13. On or about May 22, 1939 petitioner filed with the United States Patent Office an application numbered 275,092 for a patent upon another device invented by him known as a Crankshaft Grinder; and petitioner had also then invented, and had in preparation, an application for another patent on a device also known as a Crankshaft Grinder. The aforesaid patent application No. 275,092 was allowed on May 6, 1941, United States Patent No. 2,240,527 was issued thereon to petitioner, and after issuance thereof petitioner remained the owner of said patent through the year 1941. The second patent application mentioned above was filed on December 29, 1939, was numbered 311,669, was allowed on January 26, 1943, when Patent No. 2,309,615 was issued to petitioner's wife as assignee of petitioner. The second patent application numbered 311,669 was assigned by petitioner to his wife on December 29, 1942.

14. On June 20, 1939 petitioner and the company duly executed a license agreement whereby petitioner licensed [fol. 42] the company to manufacture and sell said Crankshaft Grinder for a period of ten years, and the company agreed to pay him a royalty of ten percent upon the gross sale price of said devices. A true and correct copy of said agreement is attached hereto as Exhibit 11K. Said agreement is hereinafter referred to as said Crankshaft Grinder License Agreement.

15. On or about June 20, 1939 petitioner delivered to the company a letter notifying it that he had assigned all of his right, title, and interest in said Crankshaft Grinder License Agreement to his wife—a true and correct copy of said letter being attached hereto as Exhibit 12L. In said letter of June 20, 1939 petitioner enclosed a copy of said assignment, the original assignment being delivered to petitioner's wife. A true and correct copy of said assignment is attached hereto as Exhibit 13M.

16. All of the above-mentioned assignments of license agreements by petitioner to his wife were made by peti-

tioner as gifts to his wife and the assignments were without consideration. All of such gifts made after 1932 were reported by petitioner for gift tax purposes, he having filed gift tax returns in connection therewith.

17. Pursuant to the above-mentioned license agreements and assignments the company paid to petitioner's wife the royalties mentioned below:

[fol. 43]

Royalties Paid on	1937	1938	1939	1940	1941
A. Cylinder Grinder (1928 Contract)	$4,881.35				
B. Cylinder Grinder (1938 Contract)		$3,529.21	$3,713.83	$4,951.73	$6,821.97
C. Bushing or Pinhole Grinder	15,518.68	13,789.59	15,780.50	23,259.10	123,565.38
D. Crankshaft Grinders			5,749.44	22,281.67	18,615.43
Totals	$20,400.03	$17,318.80	$25,243.77	$50,492.50	$149,002.78

Petitioner's wife included the aforesaid royalties in her Federal income tax returns for the years in which she received the same, and duly paid income taxes on said royalties. Said income taxes have not been refunded to her.

18. In connection with the determination of petitioner's income tax liability for the calendar year of 1937, petitioner and respondent duly executed a Consent dated February 27, 1943, a true and correct copy of which is attached hereto as Exhibit 14N; and petitioner and respondent also duly executed a Consent dated May 9, 1944, a true and correct copy of which is attached hereto as Exhibit 15-O.

19. In connection with the determination of petitioner's income tax liability for the calendar year of 1938, petitioner and respondent duly executed a Consent dated January 6, 1944, a true and correct copy of which is attached hereto as Exhibit 16P.

[fol. 44] 20. If this court should decide that the above-mentioned royalties paid to petitioner's wife in 1937 and

1938 are taxable to petitioner, then Sections 275(c) of the Revenue Acts of 1936 and 1938 are applicable in determining the time limit within which respondent could assess additional income taxes against petitioner for the years of 1937 and 1938; and, because of the the execution by petitioner and respondent of the Consents mentioned above (Exhibits 14N, 15-O, and 16P), the applicable statute of limitations had not run as to the years of 1937 and 1938 when the respondent, on June 28, 1944, assessed against petitioner deficiency income taxes of $5,067.11 and $4,533.01, for the calendar years of 1937 and 1938, respectively. The income tax return of petitioner for 1937 showed gross income in the amount of $38,992.40 and his return for 1938 showed gross income in the amount of $45,625.36. The amounts of income in controversy which were not included in the gross income reported on said returns were $20,400.03 for the year 1937 and $17,318.80 for the year 1938, as shown under paragraph 17 hereof.

21. Petitioner's income tax return for 1937 was filed on March 16, 1938; and petitioner's income tax return for 1938 was filed on March 15, 1939.

[fol. 45] 22. At no time during the calendar years of 1937-1941, both inclusive, or prior thereto has the petitioner, or his wife, or the company given any notice of his, her, or its desire to cancel any of the above-mentioned license agreements; and at no time during said calendar years or prior thereto has the company given any notice to petitioner or his wife of its intent to cease manufacturing the patented devices mentioned in said license agreements. Said license agreements remained in effect during said period in accordance with their terms.

23. All of the aforesaid license agreements, Exhibits 1A, 5E, 8H, and 11K, were submitted to the board of directors of the company (Sunnen Products Company) before execution thereof on its behalf; and by vote at a directors' meeting all directors, (except petitioner who was present but did not vote) approved and directed the execution of said license agreements by the officers of the company whose respective names are affixed to said agreements.

24. During the calendar years of 1937-1941, both inclusive, the directors of the company, who were respectively

elected to serve for terms of one year at the annual meeting of the stockholders held on the second Tuesday in January of each year, consisted of the following persons: (1) petitioner, (2) petitioner's wife, (3) W. A. Douglass, (4) C. J. Schuepbach, and (5) R. S. Nichols. A vote of three of said directors was required in order to take any action binding upon the company.

[fol. 46] 25. The manufacture and sale of the patented devices mentioned in the aforesaid license agreements constituted more than half of the business of the company during the calendar years of 1937-1941, both inclusive.

26. The wages and salaries paid by the company, and the number of employes to whom the same were paid (exclosive of executive officers), are shown in the following table:

Year	Number of Employees at End of Year	Total Salaries and Wages Paid
1937	90	$189,612.68
1938	101	193,584.65
1939	99	202,534.41
1940	132	266,522.38
1941	220	372,3[illegible].49

27. During the years shown below the company as of December 31st of such years, owed its creditors the following amounts:

Year	Owed Creditors
1937	$123,623.07
1938	116,071.45
1939	152,209.99
1940	188,925.67
1941	574,725.64

C. POWELL FORDCE,
Counsel for Petitioner.

J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

[fol. 47] Exhibit 1-A.

Royalty Agreement.

This Agreement, made and entered into this 10th day of January, 1928, by and between the Sunnen Products Company, a corporation organized and existing under and by virtue of the laws of the State of Missouri, Party of the First Part, and Joe Sunnen of the City of St. Louis, Missouri, Party of the Second Part, Witnesseth, that

Whereas, Joe Sunnen has invented and has applied for a patent on a device known as "cylinder grinders" for use in connection with automobile engines, the application for said Letters Patent being No. 233788, and

Whereas, the corporation is desirous of manufacturing, selling and distributing said device, it is hereby agreed between the parties hereto that the said Joe Sunnen does hereby grant and give to the Sunnen Products Company the right, license and privilege to manufacture and sell said device in the United States and foreign countries, in consideration of which the Sunnen Products Company agrees to pay to the said Joe Sunnen ten percent. (10%) of the gross sales price of said device as the same are manufactured, sold and collected for.

It is further agreed between the parties hereto that either party shall have the right, without liability for damages or breach, to cancel this license or to cease manufacturing thereunder upon six months' notice in writing to the other party. In the absence of such cancellation, this Agreement shall be and continue in force for a period of ten (10) years from the date hereof.

In Witness Whereof, the parties hereto have caused this Agreement to be executed this 10th day of January, 1928.

SUNNEN PRODUCTS COMPANY,

(Sunnen Products Seal) By Matt Sunnen, Party of the First Part.

Joe Sunnen,

Party of the Second Part.

[fol. 48] January 8, 1929.

For value received I hereby sell, assign, and transfer to Mrs. Cornelia Sunnen, all my rights title and interest in

and to the Royalty which shall accrue hereafter to me on the within Royalty contract.

JOE SUNNEN.

Royalty Lease.
Standard Cylinder Grinder.
Assigned to Cornelia Sunnen.

Jan. 8-1929.

[fol. 49] Exhibit 2-B.

Sunnen Products Co.
7900 Manchester Ave.,
St. Louis, Mo.

January 15, 1929.

Sunnen Products Co.
6417 Dale Ave.
St. Louis, Mo.

Gentlemen:—

Confirming verbal notice given you at the annual stockholders meeting held at the Company's offices on January 8th, 1929, I have for value received assigned to Cornelia Sunnen, all my rights, title and interest in the royalty contract covering "cylinder grinders", covered by letter patent No. 233788, said contract dated the 10th day of January, 1928.

Yours truly,

JOE SUNNEN.

[fol. 50] Exhibit 3-C.

St. Louis, Missouri
December 21, 1931.

Sunnen Products Co.,
7900 Manchester Ave,
St. Louis, Mo.

Gentlemen:

Mr. Murphy, representative of the United States Commissioner of Internal Revenue, has raised some question as to the completeness and sufficiency of my assignment of January 3, 1929 of my interest in the royalty contract between the company and myself, dated January 10, 1928.

I have this day executed a new assignment, confirming in all respects the previous assignment, and herewith notify you to pay the royalties accruing under said royalty contract during the year 1931 direct to Mrs. Cornelia Sunnen. Copy of new assignment is herewith attached.

Yours very truly,

JOE SUNNEN.

Notice received December 21, 1931.

SUNNEN PRODUCTS COMPANY,
By W. A. Douglass, Vice-President.

[fol. 51] Exhibit 4-D.

Assignment Of Royalty Contract.

Whereas, the undersigned, on January 3, 1929, for valuable consideration, assigned to Cornelia Sunnen all of his right, title and interest in and to a royalty contract dated January 10, 1928, between the undersigned and the Sunnen Products Company, and

Whereas, the said Cornelia Sunnen has seen fit to permit the undersigned to collect for her and on her behalf the royalties accruing after the date of said contract, during the calendar years 1929 and 1930, and

Whereas, the undersigned has heretofore acknowledged himself indebted to said Cornelia Sunnen for said royalties so collected, and

Whereas, the United States Commissioner of Internal Revenue, through his representative, has raised some question as to the sufficiency and completeness of said assignment,

Now, Therefore, in consideration of the premises and in consideration of the original consideration of said assignment, I hereby in all respects confirm said previous assignment and by this instrument do assign, transfer, set over and deliver to Cornelia Sunnen all of my right, title and interest in and to said royalty contract of January 10, 1928 between myself and said Sunnen Products Company, relating to the manufacture of the cylinder grinder described

in said royalty contract, for the calendar year 1931, particularly. And I hereby state that the royalties accruing under said royalty contract have heretofore been and are hereafter the sole and exclusive property of the said Cornelia Sunnen, and hereby declare that said royalties shall be paid to the said Cornelia Sunnen or to her order, and that she shall have the sole right to collect, receive, receipt for, retain or sue for said royalties.

In Witness Whereof, I have caused these presents to be executed this 21st day of December, 1931.

JOE SUNNEN

State Of Missouri,
City Of St. Louis.—ss.:

Personally appeared before me, Joe Sunnen, to me known to be the person who executed the foregoing instrument and who acknowledged that he executed the same as his free act and deed.

In Witness Whereof, I have caused these presents to be executed this 21st day of December, 1931.

LUCY M. STEIDLE,
(Notarial Seal) Notary Public.

My commission expires on the 10 day of January 1934.

[fol. 52] Exhibit 5-E.

Royalty Lease.

This Agreement, made and entered into this 5th day of December, 1931 by and between Sunnen Products Company, a corporation organized and existing under the laws of the State of Missouri, hereinafter called the "Corporation" Party of the First Part, and Joe Sunnen of the County of St. Louis, State of Missouri, Party of the Second Part, Witnesseth That:

Whereas, Joe Sunnen has invented a device for use in connection with repairing automobile engines, known as a "pin hole grinder", and has applied for a patent thereon on December 4, 1931, said application bearing Serial No. 578,923, and

Whereas, the Corporation has heretofore used said device since October 1, 1931, with the consent of the said Joe Sunnen, and

Whereas, the Corporation is desirous of manufacturing, selling and distributing said device, it is hereby agreed between the parties hereto that the said Joe Sunnen does hereby grant and give to the Sunnen Products Company the right, license and privilege to manufacture and sell said device in the United States and Foreign countries, in consideration of which the Sunnen Products Company agrees to pay to the said Joe Sunnen ten percent (10%) of the gross sales price of said device as the same are manufactured, sold and collected for, including those heretofore sold.

It is further agreed between the parties hereto that either party shall have the right, without liability for damages or breach, to cancel this license or to cease manufacturing thereunder upon one year's notice in writing to the other party. In the absence of such cancellation, this Agreement shall be and continue in force for a period of ten (10) years from the date hereof.

In Witness Whereof, the Party of the First Part has caused these presents to be executed by its duly authorized officers, and its corporate seal to be hereunto affixed, and the Party of the Second Part has hereunto set his hand and seal this 5th day of December, 1931.

SUNNEN PRODUCTS COMPANY,
By W. A. Douglass, Vice-President.
Party of the First Part.

JOE SUNNEN,
Party of the Second Part.

Attest:
CORNELIA SUNNEN,
Secretary.

Sunnen Products Company
Seal

[fol. 53] Exhibit 6-F.

St. Louis, Missouri

December 5, 1931.

Sunnen Products Company,
7900 Manchester Ave.,
St. Louis, Missouri.

Gentlemen:

You are hereby notified that I have assigned all my right, title and interest under royalty contract dated December 5, 1931 between myself and your company, covering the device known as a "pin hole grinder", bearing Serial No. 578,923, to Cornelia Sunnen, and I hereby direct you to pay all royalties heretofore or hereafter accruing under said royalty contract to Mrs. Cornelia Sunnen.

Copy of said assignment is herewith enclosed.

Yours very truly,

JOE SUNNEN.

Received notice and copy of assignment this 5th day of December, 1931.

SUNNEN PRODUCTS COMPANY,
By W. A. Douglass, Vice-President.

[fol. 54] Exhibit 7-G.

Assignment Of Royalty Lease And Royalty Payments To Be Due Thereunder.

In Consideration Of the sum of One Dollar ($1.00) and of other valuable consideration, the receipt whereof is hereby acknowledged, I, the undersigned, do hereby assign, transfer, set over and deliver to Cornelia Sunnen all of my right, title and interest in and to a royalty contract this day executed between myself and the Sunnen Products Company covering a device for use in connection with repair-

ing automobile engines, known as a "pin hole grinder", patent application for which bears Serial No. 578923, together with the sole right to collect and receive any royalties heretofore or hereafter accruing under said royalty agreement, the same to be collected and received by her as her sole and exclusive property, and I hereby direct that the Sunnen Products Company shall pay all royalties accrued and hereafter accruing under said contract to the said Cornelia Sunnen or to her order.

In Witness Whereof, I have caused these presents to be executed this 5th day of December, 1931.

JOE SUNNEN.

State Of Missouri,
City Of St. Louis.—ss.:

Personally appeared before me, Joe Sunnen, to me known to be the person who executed the foregoing instrument, and acknowledged that he executed the same as his free act and deed.

In Witness Whereof, I have here unto set my hand and affixed my notarial seal this 5th day of December, 1931.

My commission expires 1-10-34.

LUCY M. STEIDLE,
(Seal) Notary Public.

[fol. 55] Exhibit 8-H.

Renewal Of Royalty Lease Agreement,

This Agreement, made and entered into this 10th day of January, 1938, by and between the Sunnen Products Company, a corporation organized and existing under and by virtue of the laws of the State of Missouri, Party of the First Part, and Joe Sunnen, of the County of St. Louis, State of Missouri, Party of the Second Part, Witnesseth: that

Whereas, on November 17, 1927, Joe Sunnen of the County of St. Louis and State of Missouri, made application to

the Commissioner of Patents of the United States for Letters Patent on a "Honing Device For Cylinders", for use in connection with automobile engines, which said application, bearing Serial No. 233788, was allowed by said Commissioner of Patents on December 4, 1934, and issued as United States Letters Patent No. 1,982,836, said Joe Sunnen being the sole owner thereof; and

Whereas, said Joe Sunnen under date of January 10, 1928, entered into a royalty agreement with the Sunnen Products Company whereby, for and in consideration of the payment to said Joe Sunnen of ten percent (10%) of the gross sales price of said device, as the same was manufactured, sold and collected for, the said Sunnen Products Company was granted the right, license and privilege to manufacture and sell said device in the United States and foreign countries for a term of ten (10) years beginning on the 10th day of January, 1928, and ending on the 10th day of January, 1938; and which has now expired; and

Whereas, the said Sunnen Products Company desires to renew said royalty lease and Joe Sunnen is agreeable to such renewal for the remainder of the life of the patent, that is until December 4, 1951:

Now, Therefore, It is hereby agreed between the parties hereto, Sunnen Products Company, Party of the First Part, and Joe Sunnen, Party of the Second Part, that the said royalty lease may be and it is hereby renewed for the life of the patent, and the said Joe Sunnen does hereby grant and give to the Sunnen Products Company the right, license and privilege to manufacture and sell said above mentioned device in the United States and foreign countries; in consideration of which the said Sunnen Products Company agrees to pay to the said Joe Sunnen ten percent (10%) of the gross sales price of said device as the same is manufactured, sold and collected for.

It being further agreed between the parties hereto that either party shall have the right, without liability for damages or breach, to cancel this license or to cease manufacturing thereunder upon six month's notice in writing to the other party. In the absence of such cancellation, this

agreement shall be and continue in force for the life of the patent (December 4, 1951).

[fol. 56] In Witness Whereof the parties hereto have caused this agreement to be executed this 10th day of January, 1938.

SUNNEN PRODUCTS COMPANY
By W. A. Douglass, Vice-President,
Party of the First Part.

JOE SUNNEN,
Party of the Second Part.

Attest:
CORNELIA SUNNEN,
Secretary.

Sunnen Products Co.
Seal

[fol. 57] Exhibit 9-I.

St. Louis, Missouri
January 10, 1938

Sunnen Products Company
7900 Manchester Avenue
St. Louis, Missouri.

Gentlemen:

You are hereby notified that I have assigned all my right, title and interest under royalty contract renewal dated January 10, 1938 between myself and your company, covering the device known as "Honing Device For Cylinders" (Standard Cylinder Grinder), bearing United States Patent No. 1,982,836, to Cornelia Sunnen, and I hereby direct you to pay all royalties heretofore or hereafter accruing under said royalty contract to Mrs. Cornelia Sunnen.

Copy of said assignment is herewith enclosed.

Yours very truly,
JOE SUNNEN

Received notice and copy of
assignment this 10th day
of January, 1938.
SUNNEN-PRODUCTS COMPANY,
By W. A. Douglass,
Vice-President.

[fol. 58] Exhibit 10-J.

Assignment Of Royalty Lease And Royalty Payments To Be Due Thereunder.

In Consideration of the sum of One Dollar ($1.00) and of other valuable considerations, the receipt whereof is hereby acknowledged, I, the undersigned, do hereby assign, transfer, set over and deliver to Cornelia Sunnen all of my right, title and interest in and to a royalty contract this day executed between myself and the Sunnen Products Company covering a device for use in connection with repairing automobile engines, known as a "Honing Device for Cylinders" filed in the United States Patent Office under date of November 17, 1927, Serial No. 233,789, on which patent was allowed under date of December 4, 1934, U. S. Patent No. 1,982,836, together with the sole right to collect and receive any royalties heretofore or hereafter accruing under said royalty agreement, the same to be collected and received by her as her sole and exclusive property, and I hereby direct that the Sunnen Products Company shall pay all royalties accrued and hereafter accruing under said contract to the said Cornelia Sunnen or to her order.

The above mentioned Royalty lease is a renewal of a royalty lease heretofore entered into with the said Sunnen Products Company for a term of ten years beginning January 10, 1928 and ending January 10, 1938, which was also assigned to the said Cornelia Sunnen.

In Witness Whereof I have caused these presents to be executed this 10th day of January, 1938.

JOE SUNNEN

State Of Missouri,
City Of St. Louis.—ss.:

Personally appeared before me, Joe Sunnen, to me known to be the person who executed the foregoing instrument, and acknowledged that he executed the same as his free act and deed.

In Witness Whereof I have hereunto set my hand and affixed my notarial seal this 10th day of January, 1938.

My commission expires.....

.....
Notary Public.

[fol. 59] Exhibit 11-K.

Royalty Agreement.

This Agreement, made and entered into this 20th day of June, 1939, by and between Sunnen Products Company, a corporation organized and existing under the laws of the State of Missouri, hereinafter called the "Corporation", Party of the First Part, and Joe Sunnen of the County of St. Louis, State of Missouri, Party of the Second Part, Witnesseth, that:

Whereas, Joe Sunnen has invented a device known as a Crankshaft Grinder for use in connection with repairing automobiles, and, on May 22nd, 1939, applied to the United States Patent Office for a patent thereon, said application bearing Serial No. 275,092, and has also invented and has in preparation application for another patent on device also known as a Crankshaft Grinder, which application is soon to be filed in the United States Patent Office; and

Whereas, the corporation is desirous of manufacturing selling and distributing said devices for which patent application has been made and is to be made, it is hereby agreed between the parties hereto that the said Joe Sunnen does hereby grant and give to the Sunnen Products Company the right, license and privilege to manufacture and sell said devices aforementioned in the United States and foreign countries; In Consideration of which the Sunnen Products Company agrees to pay to the said Joe Sunnen ten percent (10%) the gross sales price of said devices as the same are manufactured, sold and collected for, including those heretofore sold, if any.

It is further agreed between the parties hereto that either party shall have the right, without liability for damages or breach, to cancel this license or to cease manufacturing thereunder upon one year's notice in writing to the other party. In the absence of such cancellation, this agreement shall be and continue in force, in respect to both of the aforementioned Crankshaft Grinder devices, for a period of ten (10) years from the date hereof.

In Witness Whereof, the Party of the First Part has caused these presents to be executed by its duly authorized officers, and its corporate seal to be hereunto affixed, and

the Party of the Second Part has hereunto set his hand and seal this 20th day of Jun., 1939.

SUNNEN PRODUCTS COMPANY,
a corporation,

By W. A. Douglass Vice President.
Party of the First Part.

(Sunnen Product's Seal)

JOE SUNNEN,
Party of the Second Part.

Attest:
Cornelia Sunnen
Secretary.

[fol. 60] Exhibit 12-L.

St. Louis, Missouri
June 20, 1939

Sunnen Products Company
7900 Manchester Avenue
St. Louis, Missouri.

Gentlemen:

You are hereby notified that I have this date assigned all my right, title and interest under Royalty Agreement dated June 20, 1939, between myself and the Sunnen Products Company covering two devices, each known as a Crankshaft Grinder, to Cornelia Sunnen, and I hereby direct you to pay all royalties heretofore or hereafter accruing under said royalty contract on said two devices to Mrs. Cornelia Sunnen.

Patent application for the first of the above mentioned devices has been filed in the Patent Office of the United States under date of May 22, 1939, and bears Serial Number 275,092; patent application on the second of said de-

vices is now in preparation and soon to be filed in said United States Patent Office.

Copy of said agreement is hereto attached.

Very truly yours,

JOE SUNNEN.

Received notice and copy of assignment this 20th day of June, 1939.

SUNNEN PRODUCTS COMPANY,
a corporation,
By W. A. Douglass Vice-President.

[fol. 61] Exhibit 13-M.

Assignment Of Royalty Lease And Of Royalty Payments To Be Due Thereunder.

In Consideration of the sum of One Dollar ($1.00) and other good and valuable considerations, the receipt whereof is hereby acknowledged, I, the undersigned, Joe Sunnen, do hereby assign, transfer, set over and deliver to Cornelia Sunnen of St. Louis County, Missouri, all my right, title and interest in and to a royalty contract this day exeeuted between myself and the Sunnen Products Company covering two devices for use in connection with repairing automobiles, each of said devices being known as a Crankshaft Grinder; patent appplication for the first of which was made under date of May 22, 1939 and bears United States Patent Office application Serial Number 275,092, and patent application for the second of which devices is now in preparation and is soon to be filed in the said United States Patent Office; together with the sole right to collect and receive any royalties heretofore or hereafter accruing under said royalty agreement, the same to be collected and received by said Cornelia Sunnen as her sole and exclusive property, and I hereby direct that the Sunnen Products Company shall pay all royalties accrued and hereafter accruing under said contract to the said Cornelia Sunnen or to her order.

In Witness Whereof, I have caused these presents to be executed this 20th day of June, 1939.

JOE SUNNEN.

State Of Misouri,
City Of St. Louis—ss.:

This day before me personally appeared Joe Sunnen to me known and known to me to be the person who executed the foregoing instrument and acknowledged that he executed the same as his free act and deed.

In Witness Whereof I have hereunto set my hand and affixed my notarial seal this 20th day of June, 1939.

My Commission expires July 9, 1941.

WILLIAM H. HELLWEGE,
(Seal) Notary Public.

[fol. 62] Exhibit 14-N.

Form 872 Duplicate
Treasury Department
Internal Revenue Service
(Revised April 1942)

Consent Fixing Period of Limitation Upon Assessment of Income and Profits Tax

Received
Feb. 26, 1943
Office
Internal Revenue Agent in Charge
St. Louis, Missouri

....., 19....

In pursuance of the provisions of existing Internal Revenue Laws Joseph Sunnen, a taxpayer (or taxpayers) of Clayton, Missouri, and the Commissioner of Internal Revenue hereby consent and agree as follows:

That the amount of any income, excess-profits, or war-profits taxes due under any return (or returns) made by or on behalf of the above-named taxpayer (or taxpayers) for the taxable year (or years) ended December 31, 1937, under existing acts, or under prior revenue acts, may be assessed

at any time on or before June 30, 1944, except that, if a notice of a deficiency in tax is sent to said taxpayer (or taxpayers) by registered mail on or before said date, then the time for making any assessment as aforesaid shall be extended beyond the said date by the number of days during which the Commissioner is prohibited from making an assessment and for sixty days thereafter.

The time within which a tax may be assessed under the provisions of Section 275(a) of the Revenue Act of 1936 has already expired. This consent shall be ineffective, therefore, to validate the assessment of a deficiency in tax for the said taxable year unless the said deficiency is predicated on the inclusion in gross income of an amount omitted therefrom in the taxpayer's return, which is properly includable therein and which is in excess of 25% of the amount of gross income stated in the return, as provided in Section 275(c).

JOSEPH SUNNEN,
Taxpayer.[1]

.....
Taxpayer.[1]

[Seal[2]]

By.....

GUY T. HELVERING,
Commissioner of Internal Revenue.
By N B E Feb. 27, 1943
(Date)

---

[1]This consent may be executed by the taxpayer's attorney or agent, provided such action is specifically authorized by a power of attorney, which, if not previously filed, must accompany the consent.

If executed with respect to a year for which a JOINT RETURN OF A HUSBAND AND WIFE was filed, this consent must be signed by both spouses unless one spouse, acting under a power of attorney, signs as agent for the other.

[2]If this consent is executed on behalf of a corporation, it shall be signed with the corporate name, followed by the signature and title of such officer or officers of the corporation as are empowered under the laws of the State in which the corporation is located to sign for the corporation, in addition to which the seal of the corporation must be affixed. Where the corporation has no seal, the consent must be accompanied by a certified copy of the resolution passed by the board of directors, giving the officer authority to sign the consent.

[fol. 63] Exhibit 15-Q.

Form 872 Duplicate
Treasury Department
Internal Revenue Service
(Revised February 1943)

Consent Fixing Period of Limitation Upon Assessment of Income and Profits Tax

C:TS:WD
CTN

Received
May 10, 1944
Technical Staff
Western Division
Saint Louis Office

May 9, 1944.

In pursuance of the provisions of existing Internal Revenue Laws Joseph Sunnen, a taxpayer (or taxpayers) of Clayton, Missouri, and the Commissioner of Internal Revenue hereby consent and agree as follows:

That the amount of any income, excess-profits, or war-profits taxes due under any return (or returns) made by or on behalf of the above-named taxpayer (or taxpayers) for the taxable year (or years) ended December 31, 1937, under existing acts, or under prior revenue acts, may be assessed at any time on or before June 30, 1944, except that, if a notice of a deficiency in tax is sent to said taxpayer (or taxpayers) by registered mail on or before said date, then the time for making any assessment as aforesaid shall be extended beyond the said date by the number of days during which the Commissioner is prohibited from making an assessment and for sixty days thereafter.

The time within which a tax may be assessed under the provisions of Section 275(a) of the Revenue Act of 1936 has already expired. This consent shall be ineffective, therefore, to validate the assessment of a deficiency in tax for the said taxable year unless the said deficiency is predicated on the inclusion in gross income of an amount omitted therefrom in the taxpayer's return, which is properly includable therein, and which is in excess of 25% of the

amount of gross income stated in the return, as provided in Section 275(c).

.....

Taxpayer.[1]

JOSEPH SUNNEN,

Taxpayer.[1]

[Seal[2]]. By.....

JOSEPH D. NUNAN, JR.,
Commissioner of Internal Revenue.
By N W B May 11-1944
(Date)

[fol. 64] Exhibit 16-P.

Form 872 Duplicate
Treasury Department
Internal Revenue Service
(Revised February 1943)

Consent Fixing Period of Limitation Upon Assessment of Income and Profits Tax

C:TS:WD
CTN

Received
Jan. 8, 1944
Technical Staff
Western Division
Saint Louis Office

Jan. 6, 1944.

In pursuance of the provisions of existing Internal Revenue Laws Joseph Sunnen, a taxpayer (or taxpayers) of

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[1]This consent may be executed by the taxpayer's attorney or agent, provided such action is specifically authorized by a power of attorney, which, if not previously filed, must accompany the consent.

If executed with respect to a year for which a JOINT RETURN OF A HUSBAND AND WIFE was filed, this consent must be signed by both spouses unless one spouse, acting under a power of attorney, signs as agent for the other.

[2]If this consent is executed on behalf of a corporation, it shall be signed with the corporate name, followed by the signature and title of such officer or officers of the corporation as are empowered under the laws of the State in which the corporation is located to sign for the corporation, in addition to which the seal of the corporation must be affixed. Where the corporation has no seal, the consent must be accompanied by a certified copy of the resolution passed by the board of directors, giving the officer authority to sign the consent.

400 South Warson Road, Clayton, Missouri, and the Commissioner of Internal Revenue hereby consent and agree as follows:

That the amount of any income, excess-profits, or war-profits taxes due under any return (or returns) made by or on behalf of the above-named taxpayer (or taxpayers) for the taxable year (or years) ended December 31, 1938, under existing acts, or under prior revenue acts, may be assessed at any time on or before June 30, 1945, except that, if a notice of a deficiency in tax is sent to said taxpayer (or taxpayers) by registered mail on or before said date, then the time for making any assessment as aforesaid shall be extended beyond the said date by the number of days during which the Commissioner is prohibited from making an assessment and for sixty days thereafter.

The time within which a tax may be assessed under the provisions of Section 275(a) of the Revenue Act of 1936 has already expired. This consent shall be ineffective, therefore, to validate the assessment of a deficiency in tax for the said taxable year unless the said deficiency is predicated on the inclusion in gross income of an amount omitted therefrom in the taxpayer's return, which is properly includable therein and which is in excess of 25% of the amount of gross income stated in the return, as provided in Section 275(c).

.....

Taxpayer.[1]

.....

Taxpayer.[1]

[Seal[2]]

By Joseph Sunnen,

Robert E. Hannegan,
Commissioner of Internal Revenue.

By N W B Jan. 10, 1944
(Date)

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[1]This consent may be executed by the taxpayer's attorney or agent, provided such action is specifically authorized by a power of attorney, which, if not previously filed, must accompany the consent.

If executed with respect to a year for which a JOINT RETURN OF A HUSBAND AND WIFE was filed, this consent must be signed by both spouses unless one spouse, acting under a power of attorney, signs as agent for the other.

[2]If this consent is executed on behalf of a corporation, it shall be signed with the corporate name, followed by the signature and title of

[fol. 65] Excerpts from the Transcript of Testimony before The Tax Court of the United States at St. Louis, Missouri, on March 19, 1945.

(Filed March 29, 1945, The Tax Court of the United States).

Joseph Sunnen, Petitioner,
Docket No. 6089 vs.
Commissioner Of Internal Revenue, Respondent.

JOHN O. PRICE called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination.

By Mr. Fordyce:

Q. State your name, please.

A. John O. Price.

Q. What is your profession, Mr. Price?

A. Certified Public Accountant.

Q. Mr. Price, have you gone over the books and records of the Petitioner's wife, Mrs. Cornelia Sunnen?

A. Yes, sir.

Q. What would you say as to her net worth in the years of 1937, '38, '39, '40 and '41?

Mr. Hormberg: I think probably the records would be the better evidence. I don't know that I should allow this testimony to go in as being the best evidence and I will object to it.

[fol. 66] The Court: Do you have the books?

Mr. Fordyce: No, Your Honor, but Mr. Price has gone over the books and is thoroughly familiar with the books as the auditor of her assets and I want him to testify, not with any idea of proving exactly what she owns or did own at that time, but what her books showed.

The Court: Of course, the books would be the best evidence. He may testify what he found and reported but it

such officer or officers of the corporation as are empowered under the laws of the State in which the corporation is located to sign for the corporation, in addition to which the seal of the corporation must be affixed. Where the corporation has no seal, the consent must be accompanied by a certified copy of the resolution passed by the board of directors, giving the officer authority to sign the consent.

is not the best evidence of what the condition of the books are since they are available.

Mr. Fordyce: May he testify what he found?

The Court: He may.

Q. According to your examination, what did you find that the books showed in regard to Mrs. Sunnen's net worth at the end of each of those years?

A. At the end of 1937, $192,773.00; at the end of 1938, $192,349.00; at the end of 1939, the amount was $203,236.00; at the end of 1940, the amount was $186,037.00; at the end of 1941, 134,053.00.

Mr. Fordyce: That is all.

Cross-Examination.

By Mr. Hormberg:

Q. Mr. Price, you audit the books of Mrs. Sunnen, the wife of the petitioner in this proceeding?

A. I do not at this time. I did up through 1940.

Q. What did those books reveal as to whether Mrs. Sunnen had an account with Mr. Sunnen and as to whether she loaned money to him, or he borrowed from her or [fol. 67] whether she borrowed from him?

A. I couldn't answer that exactly; that's been a long time ago. I would have to look it up.

Q. Do you know whether she loaned any sums of money to the petitioner during the taxable years?

Mr. Fordyce: Are you asking in regard to these years involved?

Mr. Hormberg: Yes, sir, 1937 to 1941.

A. I couldn't answer that.

Q. You don't know whether she returned or loaned any of this royalty from the Simmons Products Company to Mr. Sunnen?

A. I couldn't testify to that.

Q. You don't know?

A. No, I don't know right now. The report would show. I was not asked to prepare to answer that question and it has been a long time ago.

Q. Do you know whether the record shows whether she loaned the petitioner, or allowed the petitioner to collect

any of those royalties that she was entitled to under that assignment of the contract, whether she allowed the collection to be made by her husband?

A. Money due her, allowed it to be paid to him?

Q. Yes?

A. I have no recollection of that happening.

Mr. Hormberg: That's all.

The Court: You are excused.

(Witness excused.)

[fol. 68] (Opinion of The Tax Court of the United States in Cases Nos. 64117, 69526 and 74077.)

United States Board Of Tax Appeals.

Joseph Sunnen, Petitioner, v. Commissioner Of Internal Revenue, Respondent.

Docket Nos. 64117, 69526, 74077.

The right to receive royalty under a royalty contract relating to the manufacture and sale of a certain device known as a "cylinder grinder" is a property right, and when such contract is assigned the royalties thereafter payable thereunder are income to the assignee and not to the assignor and inventor of such device.

Thomas H. Cobbs Esq., for petitioner.

T. M. Mather, Esq., for the respondent.

MeMahon: These proceedings, duly consolidated for hearing and decision, are for the redetermination of asserted deficiencies in income tax as follows:

Year	Amount
1929	$8,388.43
1930	5,642.83
1931	4,256.14

The only question at issue is whether certain royalty income of $41,084.22, $28,097.62, and $23,108.28, returned as income for the years 1929, 1930 and 1931 by Cornelia Sunnen, wife of petitioner, is includable in the gross income of petitioner for the taxable years involved.

The facts were stipulated by the parties. We adopt stipulation as our findings of fact setting forth only those facts necessary to an understanding of the question presented.

[fol. 69] The petitioner was, during each of the taxable years, the president and record owner, with the exception of qualifying shares, of all of the capital stock of the Sunnen Products Company, a corporation, hereinafter referred to as the Company.

The petitioner had invented several devices which were being manufactured and sold by the Company under royalty agreements, and in particular, a device known as a "cylinder grinder", patented under United States Patent #233788.

Under date of January 10, 1928, the petitioner entered into an agreement with the Company whereby he granted to such Company the right, license and privilege to manufacture and sell such device known as "cylinded grinder" for a period of ten years from date thereof in the United States and foreign countries in consideration of the payment to petitioner of ten per cent of the gross sales price of such device as the same are manufactured, sold and collected for, each party having the right to cancel "this license or to cease manufacturing thereunder upon six months' notice in writing to the other party".

Under date of January 8, 1929, the petitioner executed the following assignment on the back of the above contract:

* * * * * *

For value received I hereby sell, assign, and transfer to Mrs. Cornelia Sunnen, all my rights title and interest in and to the Royalty which shall accrue hereafter to me on the within Royalty contract.

* * * * * *

Upon the back of such contract there also appears the following notation:

[fol. 70]

Royalty Lease
Standard Cylinder Grinder
Assigned to Cornelia Sunnen
Jan. 8—1929.

Under date of January 8, 1929, the Company was advised of such assignment as appears from the minutes of the

annual meeting of the board of directors of the Company held January 8, 1929 as follows:

Verbal notice was given by Mr. Joe Sunnen that he had assigned to Cornelia Sunnen, his right to receive the royalty payments called for under his royalty contract of January 10, 1928 with the Sunnen Products Company for the manufacture of the cylinder grinders and that after this date all royalty payments should be made to Cornelia Sunnen and that written notice of said assignment would be duly served upon the Company.

Under date of January 15, 1929, the petitioner addressed and signed a letter to the Company stating as follows:

* * * * * *

Confirming verbal notice given you at the annual stockholders meeting held at the Company's offices on January 8th, 1929, I have for value received assigned to Cornelia Sunnen, all my rights, title and interest in the royalty contract covering "cylinder grinders", covered by letter patent No. 233788, said contract dated the 10th, day of January 1928.

* * * * * *

During the year 1929, the petitioner's account with the Company was largely overdrawn and, upon verbal instructions from Cornelia Sunnen, assignee, given to the Company, the royalties accruing under the cylinder grinder patent were credited on the books of the Company to Joseph Sunnen, and the entire royalty from the agreement of January 10, 1928, was so credited to the account of the petitioner.

During the calendar year 1929 the petitioner's account with the Company was credited with royalties in the amounts of $29,385.06 and $23,418.87, which constitute total [fol. 71] royalties on all royalty contracts. The balance due the Company from the petitioner at the end of 1929, even with these credits, was $73,132.67. The cylinder grinder sales for 1929 totaled $410,842.20, and the royalty of $41,084.22 is included in the above 1929 credits to petitioner's account.

The petitioner charged himself on his personal books with $41,084.22 and credited such amount to the account of Cornelia Sunnen on his personal books.

On or about March 14, 1930, C. J. Schuepbach, bookkeeper of the Company, who is not an accountant and who did not prepare the income tax return for the petitioner or Cornelia Sunnen, mailed to the United States Collector in St. Louis, Form 1099, showing an amount paid to petitioner by the Company, including therein in error the amount of $41,084.22.

The income tax returns for petitioner, for his wife, and for the Company were prepared by a certified accountant who examined the minutes and records, and upon these prepared by a certified accountant who examined the i2dd prepared the three returns. The income tax return of the Company showed the amount paid to petitioner as excluding above figure of $41,084.22; the income tax return of the petitioner excluded the above amount; and the income tax return of Cornelia Sunnen returned as income the amount of $41,084.22.

Petitioner had a personal bank account, but Cornelia Sunnen, his wife, had no bank account and was not authorized to draw checks upon the bank account of petitioner. Checks on petitioner's account were drawn, either by the petitioner or by C. J. Schuepbach, who had authority to sign petitioner's name to checks on petitioner's personal [fol. 72] account, and by far the greater number of checks on his account were drawn by C. J. Schuepbach. C. J. Schuepbach had instructions from the petitioner to draw checks to Cornelia Sunnen, or on her order, to any other person at any time and in any amount. Following these instructions, C. J. Schuepbach did draw checks in payment of all the bills of Cornelia Sunnen as presented to him, without supervision by petitioner, and delivered checks to Cornelia Sunen payable to her, or to "cash", whenever desired.

Petitioner, during the calendar year 1930, was overdrawn in his account with the Company and, following verbal instructions from Cornelia Sunnen the royalties under the cylinder grinder patent were again credited to petitioner, and, at the end of the calendar year, even with the credits

of the royalty due to Cornelia Sunnen, petitioner's account was overdrawn $86,878.60.

Petitioner's account was credited on the books of the Company with $32,121.07, and $16,153.80 for royalties for 1930. The Company, however, in crediting the petitioner with the royalty account for 1930, broke down the items credited to petitioner, showing the amounts thereof due to petitioner and his wife, respectively, and showing the amounts due to Cornelia Sunnen as $20,071.88 for the first six months and $8,025.74 for the last six months, or a total of $28,097.62 for the calendar year.

Form 1099, sent in by the Company for the year 1930, did not include this item as having been paid to petitioner.

Amounts were credited to Cornelia Sunnen on the books of the petitioner aggregating $28,097.62, as royalty for the year 1930.

In the calendar year 1931, the books of the Company [fol. 73] credited Cornelia Sunnen directly with the royalties on the cylinder grinder, in the amount of $23,108.28. In 1931, no credit was extended to Joseph Sunnen on the books of the Company for this item.

In Nelson vs. Ferguson, 56 Fed. (2d) 121, certiorari denied 286 U. S. 565, the taxpayer obtained letters patent on an invention and entered into a contract with the Warner Chemical Company for the exploitation of such invention, under which he was to receive a part of the realized net profits. Taxpayer executed a contract wherein he agreed to waive his rights to receive all profits from the manufacture and sale of his invention as outlined in his contract with the Warner Company in favor of his wife and agreed to and did notify such company in writing to pay to his wife all the moneys that may become due under his contract with it. The court held that the right to certain profits vested in the taxpayer, that being a vested property right, it would have constituted a part of the taxpayer's estate had he died, and that such property right was assignable, the court continuing:

The next questions are whether Nelson's property interest in the contract was assignable to his wife and, if so, whether it was assignable in the sense of so completely

divesting him of the property and vesting it in her, that thereafter the income arising from it was taxable not as his but as hers.

[5] In answering these questions it must be kept in mind that the thing assigned was not Nelson's future salary or personal earnings as in the Earl Case and in the later case of Luce vs. Burnet, Commissioner, 55 F. (2d) 751, Court of Appeals of the District of Columbia, January 18, 1932, things not then in existence, 5 Corpus Juris, 87, but was an existing thing, namely; property in a contract. The assignment being of property was therefore not merely an assignment of income when earned, though from the property assigned profits and income were expected to flow. * * * Whether to a stranger or wife, we think the income from it should have been taxed to the assignee, not to [fol. 74] the assignor who had ceased to own or control it, Corliss vs. Bowers, 281 U. S. 376, 50 S. Ct. 336, 74 L. Ed. 916; Mitchel vs. Bowers (C. C. A.) 15 F. (2d) 287; Harris vs. Commissioner (C. C. A.) 39 F. (2d) 546, * * *.

To the same effect are J. V. Leydig, 15 B. T. A. 124, affirmed in Leydig vs. Commr., 43 Fed. (2d) 1494; Field vs. Commr., 42 Fed. (2d) 820; Copland vs. Commr., 41 Fed. (2d) 501; Elizabeth D. Smith, et al., Executors, 25 B. T. A. 291.

In Lowery vs. Helvering, 70 Fed. (2d) 713, reversing Emily Gale Lowery, 27 B. T. A. 137, the Circuit Court of Appeals for the Second Circuit stated:

Cases like Lucas vs. Earl, supra, 281 U. S. 111, 50 S. Ct. 241, 74 L. Ed. 731, and Burnet vs. Leininger, supra, 285 U. S. 136, 52 S. Ct. 345, 76 L. Ed. 665, are to be explained on quite another theory. The choses in action there transferred were indeed as absolutely transferred as though they were unconditional in obligation; but they were conditional upon continued performance by the assignor, the original obligee. There is therefore a real propriety in looking to the obligee's performance as the source of the income, though strictly his control over it is only negative. * * * However, it is not of consequence now just what is the rational foundation of the doctrine, for it has never been held to apply where the consideration has been performed and

the right become absolute. In such situations an assignment is treated as completely stripping the assignor of his rights. * * *

See also Edward G. Swartz, Inc., 69 Fed. (2d) 633, affirming Edward G. Swartz, Inc., 25 B. T. A. 1065.

In this proceeding, considering not only the assignment but the verbal and written notice to the Company and the notation on the contract, it is our opinion that the petitioner assigned every interest he had in such contract. The royalties were not contingent upon the performance by the petitioner of any services or of any obligations under the contract. The right to receive the royalties under the agreement was a vested property right of petitioner which he as- [fol. 75] signed to his wife. The petitioner assigned the property or property right which produced the income. The principle of the Nelson case, supra, and other cases cited above, is applicable here.

The respondent in support of his position on brief cites Van Meter vs. Commissioner, 61 Fed. (2d) 817, affirming 22 B. T. A. 1202; Bishop vs. Commissioner, 54 Fed. (2d) 298, affirming 19 B. T. A. 1108; Parker vs. Routzahn, 56 Fed. (2d) 730, certiorari denied 53 S. Ct. 15; James M. Stokes, Jr., 22 B. T. A. 1386; and Hazel T. Powers, 23 B. T. A. 428, affirmed in Powers vs. Commissioner, 61 Fed. (2d) 625, certiorari denied 53 S. Ct. 404. All the above cases except the Powers case involve assignments of insurance renewal commissions. As stated in Van Meter vs. Commissioner, supra:

* * * There was no assignment of the agency contract. The Van Meter Company alone acted thereunder, and it alone produced the insurance business which was the basis or earnings of the renewals. The actual effect of the assignments was to transfer to the assignees what had been solely earned by the Van Meter Company and to authorize direct payment thereof to the assignees by the Hawkeye Company. What it did with its earnings cannot affect the application of the taxing statutes. * * *

Herein the contract was assigned, and although the petitioner invented the device, the royalties did not represent income of the petitioner for services to the Company, but

were due to the manufacture and sale by the Company of the cylinder grinders, which it had the right to manufacture under the contract. The petitioner was not the producer of the income; the contract was the source of the income.

In the Powers case the taxpayer "revocably assigned, with a restraint upon alienation, 'one third of the income of the trust estate' which she 'may be or may become entitled to'".

These cases, as well as Corliss vs. Bowers, 281 U. S. 336, involving the question of liability for tax on income from a revocable trust as between the grantor of the trust and the beneficiary; Edward J. Luce, 18 B. T. A. 923, involving a declaration of trust as to future income from certain sources including the partnership of which the grantor was a member; Mitchell vs. Bowers, 15 Fed. (2d) 287, certiorari denied 273 U. S. 759, involving an assignment of one-half of the earnings of taxpayer's partnership firm to his wife, Bing vs. Bowers, 26 Fed. (2d) 1017, involving the assignment of a portion of the net income and profits from the interest of the assignor in certain realty, and John Leo Stack, 22 B. T. A. 707, involving an assignment of net profits, compensation for services rendered by assignor all cited by respondent, are obviously distinguishable on the facts and therefore are not applicable here.

It is immaterial that the wife instructed the Company to credit the account of petitioner with the 1929 and 1930 royalties. They were hers. It was within her power to revoke such instructions at will.

It follows that the respondent erred in increasing petitioner's income for the years 1929, 1930 and 1931 by the amounts of the royalties of $41,084.22, $28,097.62, and $23,108.28, respectively.

In Docket No. 69526 involving the taxable year 1930, the respondent also increased petitioner's gross income by $900 salary, as to which there is no controversy, therefore

Decision will be entered for the petitioner in Docket Nos. 64117 and 74077, and under Rule 50 in Docket No. 69526.

(Seal)

Enter: Jun 29 1935

[fol. 77] (Order of Redetermination in Case No. 64117.)

United States Board Of Tax Appeals

Joseph Sunnen, Petitioner,
Docket No. 64117. vs.
Commissioner Of Internal Revenue, Respondent.

Decision.

Pursuant to the Memorandum Opinion of the Board entered June 25, 1935, and order of July 24, 1935, the respondent on July 31, 1935, having filed notice of settlement and proposed computation, and the petitioner on August 14, 1935, having filed an acquiescence in the computation as made by the respondent, now therefore, it is

Ordered And Decided that there is a deficiency in income tax of $586.45 for the year 1929.

EUGENE BLACK,
Member.

Enter: Aug. 17, 1935.

FBH

(Seal)

[fol. 78] (Order of Redetermination in Case No. 69526.)

United States Board Of Tax Appeals

Washington

Joseph Sunnen, Petitioner,
Docket No. 69526. vs.
Commissioner Of Internal Revenue, Respondent.

Decision.

Pursuant to the memorandum opinion entered in the above-entitled proceeding on June 29, 1935 counsel for the respondent having filed a proposed final determination with notice of settlement; due notice of hearing under Rule 50 having been served on counsel for the parties; counsel for the petitioner, on August 14, 1935, having filed acquiescence

to the proposed final determination of the respondent, now therefore, it is

Ordered and Decided: that there is a deficiency in income tax for the year 1930 in the amount of $108.68.

ERNEST H. VAN FOSSAN,
Member.

Enter: Aug. 16, 1935.

(Seal)

[fol. 79] (Order of Redetermination in Case No. 74077.)

United States Board Of Tax Appeals

Joseph Sunnen, Petitioner,
Docket No. 74077. vs.
Commissioner Of Internal Revenue, Respondent.

Decision.

Pursuant to the Memorandum Opinion of the Board entered June 29, 1935, and order of July 24, 1935, the respondent on July 31, 1935, having filed notice of settlement and proposed computation, and the petitioner on August 14, 1935, having filed an acquiescence in the computation as made by the respondent, now therefore, it is

Ordered And Decided: that there is a deficiency in income tax of $162.00 for the year 1931.

EUGENE BLACK,
Member.

Enter: Aug. 17, 1935

FBH

(Seal)

[fol. 80] (Opinion and Findings of Fact of The Tax Court of the United States.)

The Tax Court of the United States.

Joseph Sunnen, Petitioner,
Docket No. 6089. vs.
Commissioner of Internal Revenue, Respondent.

Promulgated March 11, 1946.

Petitioner, owner of certain patented inventions, licensed a corporation, in which he owned 1,780 and his

wife 200 shares of its outstanding capital stock, to manufacture and sell the devices under agreements to pay a royalty of 10 per cent of the gross receipts from the sales of each device. The license agreements were for a limited period and were mutually subject to cancellation without liability on giving a prescribed notice. The agreements were assigned to petitioner's wife to whom the royalties were thereafter paid. Held:

1. The plea of res adjudicata is applicable only to the extent of royalties in the sum of $4,881.35 paid in the taxable year 1937, under the licensing agreement of January 10, 1928.

2. The remaining royalties paid in the taxable years are taxable income to petitioner. Estate of J. G. Dodson, 1 T. C. 416, followed.

[fol. 81] C. P. Fordyce, Esq., for the petitioner.

Roy C. Hormberg, Esq., for the respondent.

This controversy involves income tax deficiencies as follows:

Year	Amount
1937	$ 5,067.11
1938	4,533.01
1939	7,994.77
1940	29,540.50
1941	103,227.18

The issues are: (1) whether petitioner is taxable on the royalties paid under agreements licensing certain of his patents after the assignment of such agreements to his wife; (2) whether the doctrine of res adjudicata is applicable; and (3) whether the deficiencies for the years 1937 and 1938 were determined within the time prescribed by law. All the material facts were stipulated and are so found. They are summarized as follows:

Findings of Fact.

Petitioner is an individual residing at Clayton, Missouri. His Federal income tax returns for the periods involved were filed on a calendar year cash basis with the collector of internal revenue for the first district of Missouri.

Sunnen Products Company, a Missouri corporation (hereinafter called the "Company"), during the taxable periods was engaged in the manufacture and sale of patented grinding machines and other tools. During such years its outstanding stock consisted of 2,000 shares. Petitioner was its president and held 1,780 shares of its capital stock. [fol. 82] Cornelia Sunnen, wife of petitioner, held 200 shares, and the remaining 20 shares were held by others connected with the company.

Petitioner was an inventor. He filed applications and was issued letters patent by the government of the United States on three devices or inventions. A description of the device, the date of the filing of the applications, the date of issue of the patents and the patent numbers are as follows:

Description	Date of Application	Number Assigned Patent	Date Patent Issued
(1) Cylinder Grinder	November 17, 1927	1,982,836	December 4, 1934
(2) Pinhole Grinder	December 4, 1931	1,913,689	June 13, 1933
(3) Crankshaft Grinder	May 22, 1939	2,240,527	May 6, 1941

The petitioner remained the owner of such patents throughout the year 1941.

On December 29, 1939, petitioner filed an application for a patent on another crankshaft grinder. This application was assigned by petitioner to his wife on December 29, 1942, and patent No. 2,309,615 was issued to her on January 26, 1943.

On the following respective dates, petitioner licensed the Company to manufacture and sell said inventions and devices on a royalty basis.

Device	Date of Royalty Agreement
1. Cylinder Grinder	January 10, 1928
2. Pinhole Grinder	December 5, 1931
3. Crankshaft Grinder	June 20, 1939
4. Crankshaft Grinder No. 2	June 20, 1939

The licensing agreement with respect to the cylinder grinder, executed under date of January 10, 1928, reads as follows:

[fol. 83] Royalty Agreement.

This Agreement, made and entered into this 10th day of January, 1928, by and between Sunnen Products Company, a corporation organized and existing under and by virtue of the laws of the State of Missouri, Party of the First Part, and Joe Sunnen of the City of St. Louis, Missouri, Party of the Second Part, Witnesseth, that

Whereas, Joe Sunnen has invented and has applied for a patent on a device known as "cylinder grinders" for use in connection with automobile engines, the application for said Letters Patent being No. 233788, and

Whereas, the corporation is desirous of manufacturing, selling and distributing said device, it is hereby agreed between the parties hereto that the said Joe Sunnen does hereby grant and give to the Sunnen Products Company the right, license and privilege to manufacture and sell said device in the United States and foreign countries, in consideration of which the Sunnen Products Company agrees to pay to the said Joe Sunnen ten percent. (10%) of the gross sales price of said device as the same are manufactured, sold and collected for.

It is further agreed between the parties hereto that either party shall have the right, without liability for damages or breach, to cancel this license or to cease manufacturing thereunder upon six months' notice in writing to the other party. In the absence of such cancellation, this Agreement shall be and continue in force for a period of ten (10) years from the date hereof.

In Witness Whereof, the parties hereto have caused this Agreement to be executed this 10th day of January, 1928.

The licensing agreements covering the other devices, i. e., pinhole grinders and crankshaft grinders, were in substance the same as the above-quoted agreement. They differed only in respect to the description of the device covered, and the period for serving cancellation notice was "one year" instead of six months.

On January 10, 1938, the original royalty agreement covering the cylinder grinder device expired and petitioner executed a renewal license for the balance of the life of [fol. 84] the patent, i. e., December 4, 1951. This agreement was in substance the same as the original agreement and retained the "six month" period for serving cancellation notice.

All of the aforementioned license agreements were submitted to the Company's board of directors before execution. The board consisted of the following five members: (1) petitioner; (2) petitioner's wife; (3) W. A. Douglass; (4) C. J. Schuepbach; and (5) R. S. Nichols. A vote of three was required to take binding action. The execution of the respective agreements on behalf of the Company was authorized by the board. Petitioner was present at such meetings but did not vote thereon.

At no time during the calendar years 1937-1941, or prior thereto, was any notice of cancellation given by either petitioner, his wife or the Company, nor did the Company give any notice of intent to cease manufacturing the devices and the agreement remained in effect throughout such period in accordance with their terms.

The manufacture and sale of such patented devices constituted more than half of the business of the Company during the taxable periods involved.

Under date of January 8, 1929, petitioner endorsed upon the back of the original license agreement of January 10, 1928, respecting the cylinder grinder device, the following statement:

January 8, 1929.

For value received I hereby sell, assign, and transfer to Mrs. Cornelia Sunnen, all my rights title and interest in and to the Royalty which shall accrue hereafter to me on the within Royalty contract.

JOE SUNNEN.

[fol. 85] On the back of said agreement also appears the following:

Royalty Lease
Standard Cylinder Grinder.
Assigned to
Cornelia Sunnen

Jan. 8-1929.

Under date of January 15, 1929, petitioner wrote a letter addressed to the Company, reading as follows:

Confirming verbal notice given you at the annual stockholders meeting held at the Company's offices on January 8th, 1929, I have for value received assigned to Cornelia Sunnen, all my rights, title and interest in the royalty contract covering "cylinder grinders", covered by letter patent No. 233788, said contract dated the 10th day of January 1928.

Under date of December 21, 1931, petitioner executed and duly acknowledged a further assignment with respect to the cylinder grinder device. After certain other preliminary recitals not material here, said assignment reads as follows:

Whereas, the United States Commissioner of Internal Revenue, through his representative, has raised some question as to the sufficiency and completeness of said assignment,

Now, Therefore, in consideration of the premises and in consideration of the original consideration of said assignment, I hereby in all respects confirm said previous assignment and by this instrument do assign, transfer, set over and deliver to Cornelia Sunnen all of my right, title and interest in and to said royalty contract of January 10, 1928 between myself and said Sunnen Products Company, relating to the manufacture of the cylinder grinder described in said royalty contract, for the calendar year 1931, particularly. And I hereby state that the royalties accruing under said royalty contract have heretofore been and are hereafter the sole and exclusive property of the said Cornelia Sunnen, and hereby declare that said royalties shall be paid to the said Cornelia Sunnen or to her order, and

that she shall have the sole right to collect, receive, receipt [fol. 86] for, retain or sue for said royalties.

In Witness Whereof, I have caused these presents to be executed this 21st day of December, 1931.

JOE SUNNEN.

On the following dates petitioner executed written assignments of the renewal agreement covering the cylinder grinder, and the original Royalty Agreements covering the other devices which he had licensed to the Company.

Cylinder grinder (renewal	Jan. 10, 1938
Pinhole grinder	Dec. 5, 1931
Crankshaft grinders	June 20, 1939

Each of said assignments purported to assign all of petitioner's right, title and interest in and to the respective royalty contract and were in form and substance similar to the assignment dated December 21, 1931, hereinbefore set forth in part.

In the case of each assignment petitioner notified the Company in writing of the execution of the assignment and enclosed a copy thereof, except the original assignment of January 8, 1929, which had been endorsed on the back of the contract. All the above assignments were made as gifts by petitioner to his wife and were without consideration. All of such gifts made after 1932 were reported by petitioner for gift tax purposes.

Pursuant to the above-mentioned license agreements and assignments, the Company paid to petitioner's wife, in the taxable periods, royalties as follows:

[fol. 87]

Royalties Paid on	1937	1938	1939	1940	1941
A. Cylinder Grinder (1928 Contract)	$4,881.35				
B. Cylinder Grinder (1938 Contract)		$3,529.21	$3,713.83	$4,951.73	$6,821.97
C. Bushing or Pinhole Grinder	15,518.68	13,789.59	15,780.50	23,259.10	123,565.38
D. Crankshaft Grinders			5,749.44	22,281.67	18,615.43
Totals	$20,400.03	$17,318.80	$25,243.77	$50,492.50	$149,002.78

Petitioner's wife included these royalties in her Federal income tax returns for the years in which she received the same. She duly paid the income taxes thereon, which have not been refunded. The income tax returns of petitioner for the years 1937 and 1938 showed gross income in the respective amounts of $38,992.40 and $45,625.36.

The parties have stipulated that if the aforementioned royalties paid to petitioner's wife in 1937 and 1938 are taxable to petitioner, then section 275 (c) of the Revenue Acts of 1936 and 1938 is applicable, and under the consent agreements the deficiencies for the years 1937 and 1938 were determined within the period prescribed by law.

It was also stipulated that the opinion and decision of the Board of Tax Appeals in Joseph Sunnen, Docket Nos. 64117, 69526 and 74077, may be considered by this Court in this proceeding to the same extent as if introduced in evidence herein.

[fol. 88] Opinion.

Leech, Judge: The question presented is whether the royalties accruing under agreements licensing the manufacture and sale of patents belonging to petitioner are taxable income to petitioner after the assignment of the royalty agreements to his wife, to whom the royalties were paid. Petitioner first relies upon a plea of res adjudicata. The basis for the plea is our decision in the case of Joseph Sunnen, Docket Nos. 64117, 69526 and 74077, entered June 29, 1935. The validity of this plea must first be determined, since if the plea is sound it will dispose of the controversy. The prior action and decision related to the taxable years 1929, 1930 and 1931. The parties were the same as those here. The question litigated was whether the royalties paid in those years pursuant to a licensing agreement dated January 10, 1928, which had been assigned to his wife on January 8, 1929, were taxable income of the petitioner. It was there held that those royalties were not taxable to petitioner. One of the issues in the instant proceeding is the same as that presented and determined in the prior proceeding except the action or claim is different in that it has to do with taxes for a later year, i. e., the taxable year. That issue relates to royalties in the amount of $4,881.35. paid to the assignee in 1937, pursuant to the royalty agree-

ment of January 10, 1928 covering the device known as a "cylinder grinder". It is the established law that where a controlling fact or matter is in issue between the same parties and such fact or matter is again put in issue in a subsequent suit between the same parties or their privies, the former adjudication, if pleaded, will be conclusive of [fol. 89] the issue in the later suit whether or not the cause of action is the same in both suits. Tait v. Western Maryland Ry Co., 289 U.S. 620; Southern Pacific R.R. Co. v. United States, 168 U.S. 1. We do not think this rule has been modified or changed by the case of Blair v. Commissioner, 300 U.S. 5, where the Supreme Court found that a new, controlling fact had intervened rendering inapplicable the doctrine of res adjudicata. We are not unmindful of recent decisions tending to limit the application of the Tait case, supra, as applied to tax litigation.[1] Until the rule is more clearly defined, however, we do not believe the doctrine of the Blair case requires a holding that any new legal concept enunciated in a subsequent decision, when the statutory law remains the same, renders the doctrine of res adjudicata inapplicable where the controlling facts and issues are identical. Tait v. Western Maryland Ry. Co., supra; Arundel-Brooks Concrete Corporation, 4 T.C. 938.[2]

With respect to the royalty payment in 1937 of $4,881.35, there is a complete identity of issues and parties. The only new circumstance here is that under later decisions of the Supreme Court our former decision would, or at least [fol. 90] might, have been different. However, the fact that our decision may have been or even was erroneous does not furnish a basis for a denial of the application of the doctrine of res adjudicata. Tait v. Western Maryland Ry. Co., supra. We therefore sustain the plea of res adjudicata as to the royalties in the amount of $4,881.35 paid in 1937 under the licensing agreement of January 10, 1928. Respondent erroneously included them in petitioner's gross income for that taxable year.

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[1]Pelham Hall Co. v. Hassett, 147 Fed. (2d) 63; Monteith Bros. Co. v. United States, 142 Fed. (2d) 139; Commissioner v. Western Union Tel. Co., 141 Fed. (2d) 774; Commissioner v. Security-First Nat. Bank of Los Angeles, 148 Fed. (2d) 937; Henricksen v. Seward, 135 Fed. (2d) 986.

[2]Reversed, Commissioner v. Arundel-Brooks Concrete Corp., ...Fed. (2d) ...., (December 10, 1945).

We do not agree, however, with petitioner's contention that the plea of res adjudicata is valid as to the royalties paid in subsequent taxable years under the renewal contract of January 10, 1938, nor to any of the royalties paid in any of the taxable years respecting the other inventions or devices. None of these royalty contracts or assignments were in issue in the prior proceedings.

The royalty agreement with respect to the "crankshaft grinders" did not come into existence until June 20, 1939. Although the royalty agreement and assignment with respect to the "pinhole" device were dated December 5, 1931, that agreement and assignment were not before the Court in the prior proceeding. As we have observed, the validity of a plea of res adjudicata where the cause of action is different rests upon the premises that the very matter or thing in issue in the latter suit must have been adjudicated in the earlier action. A question can not have been adjudged before the subject matter basing the ques- [fol. 91] tion came into existence. National Bank of Louisville v. Stone, Auditor, 174 U. S. 432, 435. New Orleans v. Citizens Bank, 167 U. S. 371. Identity of principle involved does not base a plea of res adjudicata. Snyder v. Commissioner, 73 Fed. (2d) 5. New contracts respecting other subjects create new and different controlling issues. Harris-Emery Co., 37 B. T. A. 958; D. F. Strickland, 32 B. T. A. 804. We conclude that the plea of res adjudicata is not valid as to the deficiencies for the taxable years 1938, 1939, 1940 or 1941, nor to the $15,518.68 royalties paid in the taxable year 1937 under the agreement respecting the "pinhole grinder" device.

On the merits, the respondent contends that the assignments of the royalty agreements were mere anticipatory agreements to divert and reallocate income from petitioner's property to petitioner's wife, and under the authorities he is taxable thereon. Helvering v. Horst, 311 U. S. 112; Helvering v. Eubank, 311 U. S. 122; Lucas v. Earl, 281 U. S. 111; Harrison v. Schaffner, 312 U. S. 579; Estate of J. G. Dodson, 1 T. C. 416. In the Dodson case petitioner's decedent was the sole owner of a formula protected by trademark. He licensed a corporation, in which he held a majority stock interest, to use the

formula and trademark on a royalty basis. Later he assigned a half-interest in the royalty agreement to his wife. The decedent retained title to the formula and trademark. We sustain the respondent in taxing the income from this half-interest to decedent. In the case at bar petitioner was the sole owner of certain patented devices. He entered into agreements licensing a corporation, in which he held 1,780 of the 2,000 shares of outstanding capital [fol. 92] stock, to manufacture and sell such patented devices for a prescribed period upon a royalty basis. He retained title to all the patents for the periods here involved. The license agreements were for a limited period of time, mutually subject to cancellation without liability on notice of either a six-month or one-year period. Either concurrently with the execution of the royalty agreements, or shortly thereafter, petitioner assigned the royalty agreements to his wife, who received the royalties paid thereunder. We think the facts in these two cases are so closely parallel as to make the Dodson case apposite. Thus, upon that authority, we conclude that all the royalties paid under the licensing agreements during the taxable years, except as to the amount of $4,881.35 paid in 1937 and held excludable under the doctrine of res adjudicata, were, in fact, taxable income of petitioner.

In view of our holding that all the royalties paid, except the amount of $4,881.35, were taxable to petitioner, it follows under the stipulation that the deficiencies were determined within the period prescribed by law.

Reviewed by the Court.

Decision will be entered under Rule 50.

Van Fossan, J., dissents.

Seal of The Tax Court Of The U. S.

[fol. 93] (Order of Redetermination, May 8, 1946.)

The Tax Court Of The United States

Washington

Joseph Sunnen, Petitioner,
Docket No. 6089 vs.
Commissioner Of Internal Revenue, Respondent.

Decision.

Pursuant to agreed computation of the parties filed in the above entitled proceeding May 3, 1946, it is hereby

Ordered and Decided: That there are deficiencies in income tax for the years 1937 to 1941, inclusive, in the respective amounts of $3,699.40, $4,533.01, $7,994.77, $29,540.50 and $103,227.18.

EUGENE BLACK,
Judge.

Enter: May 8, 1946
gwc

Seal of The
Tax Court
Of The U. S.

[fol. 94] (Petition of Joseph Sunnen for Review of Decisions of The Tax Court of the United States.)

(Filed July 30, 1946, The Tax Court of the United States.)

In The Circuit Court Of Appeals For The Eighth Circuit.

Joseph Sunnen, Petitioner,
Docket No. 6089 vs. Tax Court
Commissioner Of Internal Revenue, Respondent.

To The Honorable Judges Of The United States Circuit Court Of Appeals For The Eighth Circuit:

Joseph Sunnen, petitioner, by his attorn[illegible] C. P. Fordyce, hereby files his Petition for Revie[illegible] by the United States Circuit Court of Appeals for the Eighth

Circuit of a decision of The Tax Court of the United States (6 TC—#55) and states that:

I. Jurisdiction.

The petitioner, an individual residing in the City of Ladue, St. Louis County, Missouri, filed his federal income tax returns for the calendar years of 1937, 1938, 1939, 1940 and 1941 with the Collector of Internal Revenue for the First District of Missouri, which is within the jurisdicton of the United States Circuit Court of Appeals for the Eighth Circuit.

This Petition for Review is brought pursuant to the provisions of Section 1141 and Section 1142 of the Internal Revenue Code, Title 26 USCA, for a review of a decision of The Tax Court of the United States entered in the above-entitled cause on May 8, 1946.

[fol. 95] II. Prior Proceedings.

On June 28, 1944 the Commissioner of Internal Revenue mailed to petitioner a notice of deficiency determining deficiencies in petitioner's federal income taxes in the amounts and for the taxable periods shown below:

Calendar Year	Deficiencies Asserted
1937	$5,067.11
1938	4,533.01
1939	7,994.77
1940	29,540.50
1941	103,227.18

On September 21, 1944 petitioner filed with The Tax Court of the United States, his petition appealing from the proposed deficiencies. The matter was duly heard by The Tax Court on March 19, 1945 on stipulation of facts and oral testimony.

On March 11, 1946 the Tax Court promulgated its opinion and on May 8, 1946 it entered its decision, holding that there are deficiencies in income tax due by petitioner in the amounts and for the calendar years shown below:

Calendar Year	Deficiencies
1937	$3,699.40
1938	4,533.01
1939	7,994.77
1940	29,540.50
1941	103,227.18

III. Nature Of Controversy.

The three issues in controversy are: (1) Whether petitioner is taxable on royalties paid to his wife during calendar years 1937-1941 both inclusive, by Sunnen Products Company, a Missouri corporation, (hereinafter for con- [fol. 96] venience referred to as "The Company"), (2) whether the doctrines of res judicata or stare decisis are applicable in determining petitioner's liability for some or all of the aforesaid calendar years, and (3) whether the aforesaid deficiencies for the calendar years of 1937 and 1938 were determined by the Commissioner within the time prescribed by law.

On the first issue the nature of the controversy between the parties may be briefly explained as follows:

During the calendar years here involved, petitioner owned 1780 shares of stock in the Company. His wife owned 200 shares of said stock, and three other individuals owned in the aggregate 20 shares of said stock. Said Company was engaged in the business of manufacturing and selling certain tools used in the business of repairing internal combustion engines.

Petitioner invented three tools, known respectively as a "cylinder grinder", a "pinhole grinder", and a "crankshaft grinder". Petitioner applied for patents on these tools and said patents were eventually issued to him or his assignees. However, during the years here involved petitioner owned the patents or patent applications on said tools.

On January 10, 1928 petitioner and the Company entered an agreement whereby petitioner licensed it to manufacture and sell the cylinder grinder for ten years and it agreed to pay him a royalty of 10% on the gross sales price. This agreement expired on January 10, 1938 and on

said date petitioner and the Company entered into a renewal agreement whereby petitioner licensed the Company [fol. 97] to manufacture and sell said cylinder grinder until December 4, 1951 (the expiration date of the cylinder grinder patent), in consideration of its agreement to pay him a royalty of 10%.

On December 5, 1931, petitioner and the Company entered into an agreement whereby he licensed it to manufacture and sell the pinhole grinder for 10 years and the Company agreed to pay him a royalty of 10%.

On June 20, 1939, petitioner and the Company entered into an agreement whereby he licensed it to manufacture and sell the crankshaft grinder for 10 years and the Company agreed to pay him a royalty of 10%.

Shortly after the execution of the aforesaid license agreements, petitioner duly executed written assignments whereby he assigned to his wife all of his right, title and interest in and to said license agreements and authorized and directed the Company to pay the prescribed royalties to her. The Company made said payments and petitioner's wife paid income taxes on all royalties received by her from the Company.

The petitioner did not include said royalties so paid to his wife in his income tax returns for the calendar years 1937-1941, both inclusive.

The Commissioner held that the royalties were taxable to petitioner under Section 22(a) of the Revenue Acts of 1936 and 1938, and the Internal Revenue Code, and determined that the petitioner owed the aforesaid deficiencies.

The deficiencies determined by the Commissioner for 1938, 1939, 1940, and 1941, were approved by the Tax Court. [fol. 98] on authority of its decision in The Estate of J. G. Dodson vs. Commisioner, 1 TC 416. The deficiency asserted for 1937 was reduced from $5,067.11 to $3,699.40.

On the second issue the controversy between the parties involves the effect to be given to the memorandum decision of the United States Board of Tax Appeals in the case of Joseph Sunnen vs. Commissioner, Docket Nos. 64117, 69526, and 74077, promulgated on June 29, 1935. In that

case the Board held that as petitioner had assigned to his wife the property—the royalty agreement—which produced the income, petitioner was not liable for income taxes for the calendar years 1929, 1930, and 1931 on the cylinder grinder royalties paid to his wife by the Company pursuant to the above-mentioned assignment by petitioner to her of all of petitioner's right, title and interest in and to the original cylinder grinder license agreement executed on January 10, 1928.

In determining the deficiencies for 1937-1941 both inclusive, the Commissioner gave no effect to said prior decision so obtained by petitioner.

The Tax Court held that said prior decision was res judicata upon the question of petitioner's liability for 1937 income taxes on the cylinder grinder royalties paid in 1937 to petitioner's wife under the original cylinder grinder license agreement dated January 10, 1928, which was involved in said prior decision and which was in effect in 1937. Nevertheless, The Tax Court held that said prior decision could not be used to justify application of the doc- [fol. 99] trines of res judicata or stare decisis in determining petitioner's liability for income taxes for 1938-1941 both inclusive, on royalties paid under the other license agreements mentioned above.

The controversy between the parties on the third issue involves the question of whether or not the Commissioner made a timely assessment of the 1937 and 1938 deficiencies. This question turns upon the further question of whether or not the Commissioner has borne the burden of proving that the royalties paid to petitioner's wife in 1937 and 1938 are properly a part of the petitioner's gross income for said years. If the Commissioner has not borne such burden, then his assessment of the deficiencies for 1937 and 1938 was beyond the time specified in Section 275(a) Revenue Acts of 1936 and 1938. If the Commissioner has borne such burden, then he assessed said deficiencies for said years within the five-year time limit specified in Section 275(c) of said Acts, as extended by consents executed by the parties. The Tax Court held that all deficiencies were assessed in due time.

IV. Points Relied Upon By Petitioner.

1. The Tax Court erred in holding that all royalties paid (except cylinder grinder royalties of $4,881.35 paid in 1937) by Sunnen Products Company to petitioner's wife during the calendar years 1937-1941 both inclusive, constituted income taxable to petitioner under Section 22(a) of the Revenue Acts of 1936 and 1938, and the Internal Revenue Code.

[fol. 100] 2. The Tax Court erred in holding that its decision in The Estate of J. G. Dodson vs. Commissioner, 1 TC 416, justifies taxing petitioner upon the royalties mentioned in paragraph 1 above.

3. The Tax Court erred in holding that the memorandum decision of the Board of Tax Appeals in the case of Joseph Sunnen vs. Commissioner (Docket Nos. 64117, 69526, 74077, promulgated June 29, 1935) does not justify application of the doctrines of res judicata or stare decisis in determining petitioner's liability for income taxes on the royalties mentioned in paragraph 1 above.

4. The Tax Court erred in holding that the aforesaid memorandum decision justifies application of the doctrine of res judicata only in determining petitioner's liability for income taxes for 1937 on the cylinder grinder royalties of $4,881.35 paid in said year by Sunnen Products Company to petitioner's wife.

5. The Tax Court erred in holding that the Commissioner determined the deficiencies for 1937 and 1938 within the time prescribed by law.

6. The Tax Court erred in holding that the Commissioner has borne the burden of proving that petitioner is liable for income taxes upon all royalties paid by Sunnen Products Company to petitioner's wife in 1937 and 1938 (except cylinder grinder royalties paid in 1937).

7. The Tax Court erred in ordering and deciding that there are deficiencies of income tax owed by petitioner in [fol. 101] the amounts and for the years shown below:

Calendar Year	Deficiency
1937	$ 3,699.40
1938	4,533.01
1939	7,994.77
1940	29,540.50
1941	103,227.18

Wherefore, your petitioner prays that the decision of The Tax Court of the United States be reviewed by this Court, that proper action be taken to correct the errors and omissions of The Tax Court, and that the Tax Court be directed to enter an order in the above-entitled cause to the effect that no deficiencies are due by petitioner for any of the above-mentioned years.

C. P. FORDYCE,
Attorney for Petitioner,
506 Olive Street,
St. Louis 2, Mo.

State Of Missouri,
City Of St. Louis.—ss.:

C. P. Fordyce, being duly sworn, says that he is attorney of record for the above-named petitioner and as such is duly authorized to verify the foregoing petition for review; that he has read said petition and is familiar with the contents thereof and that said petition is true to his own knowledge.

C. P. FORDYCE,
Attorney of Record.

Subscribed and sworn to before me this 24th day of July, 1946.

My commission expires Nov. 25, 1947.

(Notarial Seal)

MARIE LANG,
Notary Public.

[fol. 102] (Notice of Filing of Petition for Review by Joseph Sunnen and Acknowledgment of Service.)

(Filed July 30, 1946, The Tax Court of the United States.)

To J. P. Wenchel,
Chief Counsel, Bureau Of Internal Revenue,
Washington, D. C.:

Please Take Notice that Joseph Sunnen has filed with the Clerk of The Tax Court of the United States at Washing-

ton, D. C., a Petition for Review by the United States Circuit Court of Appeals for the Eighth Circuit of the decision of The Tax Court heretofore rendered in the above-mentioned cause. A copy of the Petition for Review and Statement of Points mentioned therein is hereto attached and served upon you.

Dated this 30th day of July, 1946.

C. P. FORDYCE,
Attorney for Petitioner,
506 Olive Street,
St. Louis 2, Mo.

Due service of the above and foregoing Notice, together with a copy of the Petition for Review and Statement of Points mentioned therein, is hereby acknowledged this 30th day of July, 1946.

J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

[fol. 103] (Petition of Commissioner of Internal Revenue for Review of Decision of The Tax Court of the United States.)

(Received and Filed August 6, 1946, The Tax Court of the United States.)

In The United States Circuit Court Of Appeals

For The Eighth Circuit

Commissioner Of Internal Revenue,
Petitioner on Review,
T. C. Docket No. 6089. vs.
Joseph Sunnen, Respondent on Review.

To the Honorable Judges of the United States Circuit Court of Appeals for the Eighth Circuit:

The Commissioner of Internal Revenue hereby petitions the United States Circuit Court of Appeals for the Eighth Circuit to review the decision entered by The Tax Court of the United States on May 8, 1946, ordering and deciding that there are deficiencies in income tax due from the tax-

payer, Joseph Sunnen, the respondent on review, for the years 1937 to 1941, inclusive, in the respective amounts of $3,699.40, $4,533.01, $7,994.77, $29,540.50 and $103,227.18. This petition for review is filed pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code. The taxpayer's Federal income tax returns for the years 1937 to 1941, inclusive, were filed with the Collector of Internal Revenue for the First District of Missouri, whose office is located at St. Louis, Missouri, and within the judicial circuit of the United States Circuit Court of Appeals for the Eighth Circuit, wherein this review is sought. [fol. 104] The question presented is whether the Tax Court erred in sustaining the plea of res judicata as to the royalties in the amount of $4,881.35 paid in 1937 under the licensing agreement of January 10, 1928, and in holding that the Commissioner erroneously included them in taxpayer's gross income for that taxable year. The plea of res judicata was based upon a prior decision of the Board of Tax Appeals in the case of Joseph Sunnen, Docket Nos. 64117, 69526 and 74077, entered June 29, 1935, in which it was held that the royalties paid in the taxable years 1929, 1930 and 1931, under the licensing agreement of January 10, 1928, were not taxable to taxpayer.

In the instant case the Tax Court had before it the general question as to whether the royalties accruing for the taxable years 1937 to 1941, inclusive, under certain agreements licensing the manufacture and sale of patents belonging to taxpayer are taxable income to taxpayer after the assignment of the royalty agreements to his wife, to whom the royalties were paid. On various dates taxpayer licensed the Sunnen Products Co., a Missouri corporation, in which he owned 1,780 and his wife 200 of its 2,000 shares of outstanding capital stock, to manufacture and sell the devices on a royalty basis. The agreements were assigned to taxpayer's wife, to whom the royalties were thereafter paid. The first license agreement involved is dated January 10, 1928, and it was assigned to taxpayer's wife on January 8, 1929. The only royalties accruing under this agreement and paid to taxpayer's wife in the taxable years was the [fol. 105] sum of $4,881.35 in 1937. This agreement ex-

pired January 10, 1938, and on the same date taxpayer executed a renewal license which was substantially the same as the original agreement. Under the renewal agreement royalties were paid to taxpayer's wife in the taxable years 1938, 1939, 1940 and 1941. Royalties under other license agreements were also paid to taxpayer's wife in the taxable years 1937 to 1941, inclusive. The tax Court held that all the royalties paid under the licensing agreements during the taxable years 1937 to 1941, inclusive, except as to the amount of $4,881.31 paid in 1937 and held excludible under the doctrine of res judicata, were taxable to taxpayer.

The Commissioner now assigns the following points on which he intends to rely in this proceeding:

The Tax Court of the United States erred:

1. In sustaining the plea of res adjudicata as to royalties in the amount of $4,881.35 paid in 1937 under the licensing agreement of January 10, 1928, and in holding that the Commissioner erroneously included them in taxpayer's gross income for that taxable year.

2. In failing to uphold the determination of the Commissioner that the royalties in the amount of $4,881.35 paid in 1937 under the licensing agreement of January 10, 1928, were taxable to taxpayer.

3. In holding that there is a deficiency in income tax for the year 1937 of only $3,699.40, and in failing to hold that there is a deficiency in income tax of $5,067.11 for the year 1937.

[fol. 106] 4. In that its opinion and decision are contrary to law.

DOUGLAS W. McGREGOR,
Assistant Attorney General.

J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.
Attorneys for Petitioner on Review.

[fol. 107] (Notice of Filing of Petition for Review by Commissioner of Internal Revenue and Acknowledgment of Service by Counsel for Respondent.)

(Received August 6, 1946, and Filed August 6 and 12, 1946, The Tax Court of the United States.)

To: C. Powell Fordyce, Esquire,
506 Olive Street,
St. Louis 1, Missouri.

You are hereby notified that the Commissioner of Internal Revenue did on the 6th day of August, 1946, file with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Eighth Circuit, of the decision of the Tax Court heretofore rendered in the above-entitled cause. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 6th day of August, 1946.

VICTOR S. MERSCH
Clerk, The Tax Court of the U.S.

Service of the above and foregoing notice, together with a copy of the petition for review mentioned therein, is hereby acknowledged this 8th day of August, 1946.

C. POWELL FORDYCE
Attorney for Respondent on Review.

[fol. 108] (Notice of Filing of Petition for Review by Commissioner of Internal Revenue and Acknowledgement of Service by Respondent on Review.)

(Received and Filed August 16, 1946, The Tax Court of the United States.)

To: Mr. Joseph Sunnen,
400 South Warson Road,
Clayton, Missouri.

You are hereby notified that the Commissioner of Internal Revenue did on the 6th day of August, 1946, file with the Clerk of The Tax Court of the United States, at

Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Eighth Circuit, of the decision of the Tax Court heretofore rendered in the above-entitled cause. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 6th day of August, 1946.

J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review mentioned therein, is hereby acknowledged this 8 day of August, 1946.

JOSEPH SUNNEN,
Respondent on Review.

[fol. 109] (Joint Praecipe for Transcript on Petitions for Review.)

(Filed August 6, 1946, The Tax Court of the United States.)

In The United States Circuit Court Of Appeals For The Eighth Circuit.

Joseph Sunnen, Petitioner and Respondent on Review, Docket No. 6089 vs. The Tax Court Commissioner Of Internal Revenue, Respondent and Petitioner on Review.

To The Clerk Of The Tax Court Of The United States:

You Are Hereby requested to prepare, certify and transmit to the Clerk of the United States Circuit Court of Appeals for the Eighth Circuit, with reference to the Petitions for Review heretofore filed by petitioners in the above-entitled causes, a transcript of the record in the above-entitled causes, prepared and transmitted as required by law and by the rules of said Court and to include in said transcript of record the following documents or certified copies thereof:

(1) Docket entries of proceedings before The Tax Court of the United States

(2) Pleadings before The Tax Court as follows:

(a) Petition, including Exhibit A

(b) Answer

(c) Reply

(3) Stipulation of facts, including all exhibits attached thereto and made a part thereof

(4) Testimony of John O. Price.

(5) Memorandum opinion and decision of the United States Board of Tax Appeals in cause entitled "Joseph Sunnen, petitioner, vs. Commissioner of Internal Revenue, respondent, Docket Nos. 64117, 69526, and 74077, entered on June 29, 1935

(6) The findings of fact and opinion of The Tax Court of the United States promulgated on March 11, 1946

(7) Decision of The Tax Court of the United States entered on May 8, 1946

[fol. 110] (8) Petition for review filed by petitioner Joseph Sunnen in this cause and notice of filing with acknowledgment of service by respondent, Commissioner of Internal Revenue.

(9) This designation of contents of record on review.

(10) Petition for review filed by Commissioner of Internal Revenue, together with proof of service of notice of filing petition for review and of service of a copy of petition for review.

C. P. FORDYCE,
Attorney for Petitioner,
506 Olive Street,
St. Louis 2, Mo.

Service of a copy of the foregoing designation is hereby acknowledged as having been made on this 6th day of August, 1946, and agreed to.

J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue,
Attorney for Respondent.

[fol. 111] (Clerk's Certificate to Transcript.)

The Tax Court Of The United States

Washington

Joseph Sunnen, Petitioner,

Docket No. 6089 vs.

Commissioner Of Internal Revenue, Respondent.

I, Victor S. Mersch, clerk of The Tax Court of the United States do hereby certify that the foregoing pages, 1 to 110, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 16th day of August, 1946.

VICTOR S. MERSCH,
Clerk,
The Tax Court of the United States.
EMT

Seal of The
Tax Court
Of The U. S.

Filed Aug. 29, 1946, E. E. Koch, Clerk.

[fol. 112] (Stipulation as to division of cost of printing record; for Consolidation of cases for briefing and argument, and as to times for filing briefs.)

(Filed in U. S. Circuit Court of Appeals on September 9, 1946:)

United States Circuit Court Of Appeals For The Eighth Circuit.

Joseph Sunnen, Petitioner,

No. 13,425 vs.

Commissioner Of Internal Revenue, Respondent.

Commissioner of Internal Revenue, Petitioner,

No. 13,426 vs

Joseph Sunnen, Respondent.

It is hereby stipulated in connection with the above-entitled cases, subject to the approval of the Court, that:

1. The cost of printing the joint record for both cases will be paid one-half by each party.

2. The two cases are to be consolidated for briefing and argument.

3. The brief on behalf of Joseph Sunnen covering the issues involved in both appeals will be filed on or before December 1, 1946; the brief on behalf of the Commissioner of Internal Revenue covering the issues in both appeals will be filed on or before January 1, 1947; and the reply brief on behalf of Joseph Sunnen will be filed on or before January 20, 1947.

C. P. FORDYCE,
Counsel for Joseph Sunnen,

D. W. McGREGOR,
Assistant Attorney General,
Counsel for the Commissioner of Internal Revenue.

September 7, 1946.

(Endorsed): Nos. 13,425 and 13,426. Filed in U. S. Circuit Court of Appeals on September 9, 1946.

And thereafter the following proceedings were had in said causes in the Circuit Court of Appeals, viz:

(Appearance of Counsel for Petitioner in Cause No. 13425.)

United States Circuit Court of Appeals

Eighth Circuit

No. 13425

JOSEPH SUNNEN, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE

The Clerk will enter my appearance as Counsel for the Petitioner.

C. P. FORDYCE,
506 Olive St., St. Louis (1), Mo.
HENRY J. RICHARDSON,
Transportation Bldg., Washington, D. C.

[Endorsed:] Filed in U. S. Circuit Court of Appeals, Aug. 31, 1946.

(Appearance of Mr. Douglas W. McGregor and Mr. Sewall Key as Counsel for Respondent in Cause No. 13425.)

The Clerk will enter our appearance as Counsel for the Respondent.

DOUGLAS W. MCGREGOR,
Assistant Attorney General,
SEWALL KEY,
Special Assistant to the Attorney General,
Department of Justice, Washington 25, D. C.

[Endorsed:] Filed in U. S. Circuit Court of Appeals, Sept. 5, 1946.

(Appearance of Mr. J. P. Wenchel and Mr. John M. Morawski as Counsel for Respondent in Cause No. 13425.)

The Clerk will enter my appearance as Counsel for the Respondent.

J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue,
JOHN M. MORAWSKI,
Special Attorney, Bureau of Internal Revenue,
Washington 25, D. C.

[Endorsed:] Filed in U. S. Circuit Court of Appeals, Sept. 7, 1946.

756048—47——1

(Appearance of Mr. Robert N. Anderson and Miss Helen Goodner as Counsel for Respondent in Cause No. 13425.)

The Clerk will enter our appearances as Counsel for the Respondent.

SEWALL KEY,
Acting Assistant Attorney General.
ROBERT N. ANDERSON,
HELEN GOODNER,
Special Assistants to the Attorney General.

[Endorsed:] Filed in U. S. Circuit Court of Appeals, Jan. 20, 1947.

(Appearance of Mr. Hilbert P. Zarky as Counsel for Respondent in Cause No. 13425.)

The Clerk will enter my appearance as Counsel for the Respondent.

HILBERT P. ZARKY,
Special Assistant to the Attorney General.

[Endorsed:] Filed in U. S. Circuit Court of Appeals, Mar. 5, 1947.

(Appearance of Mr. Douglas W. McGregor and Mr. Sewall Key as Counsel for Petitioner in Cause No. 13426.)

United States Circuit Court of Appeals

Eighth Circuit

No. 13426

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

JOSEPH SUNNEN

The Clerk will enter our appearance as Counsel for the Petitioner.

DOUGLAS W. MCGREGOR,
Assistant Attorney General.
SEWALL KEY,
Special Assistant to the Attorney General,
Department of Justice, Washington 25, D. C.

[Endorsed:] Filed in U. S. Circuit Court of Appeals, Sept. 5, 1946.

(Appearance of Mr. J. P. Wenchel and Mr. John M. Morawski as Counsel for Petitioner in Cause No. 13426.)

The Clerk will enter my appearance as Counsel for the Petitioner.

J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue.
JOHN M. MORAWSKI,
Special Attorney, Bureau of Internal Revenue,
Washington 25, D. C.

[Endorsed:] Filed in U. S. Circuit Court of Appeals, Sept. 7, 1946.

(Appearance of Mr. Robert N. Anderson and Miss Helen Goodner as Counsel for Petitioner in Cause No. 13426.)

The Clerk will enter our appearances as Counsel for the Petitioner.

SEWALL KEY,
Acting Assistant Attorney General.
ROBERT N. ANDERSON,
HELEN GOODNER,
Special Assistants to the Attorney General.

[Endorsed:] Filed in U. S. Circuit Court of Appeals, Jan. 20, 1947.

(Appearance of Mr. Hilbert P. Zarky as Counsel for Petitioner in Cause No. 13426.)

The Clerk will enter my appearance as Counsel for the Petitioner.

HILBERT P. ZARKY,
Special Assistant to the Attorney General.

[Endorsed:] Filed in U. S. Circuit Court of Appeals, Mar. 5, 1947.

(Appearance of Counsel for Respondent in Cause No. 13426.)

The Clerk will enter my appearance as Counsel for the Respondent,

C. P. FORDYCE,
506 Olive St., St. Louis (1), Mo.
HENRY J. RICHARDSON,
Transportation Bldg., Washington, D. C.

[Endorsed:] Filed in U. S. Circuit Court of Appeals, Aug. 31, 1946.

Order of Submission in Causes Nos. 13425 and 13426

United States Circuit Court of Appeals, Eighth Circuit

March Term, 1947. Wednesday, March 5, 1947

No. 13425

JOSEPH SUNNEN, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

On Petition to Review Decision of The Tax Court of the United States

and

No. 13426

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

JOSEPH SUNNEN

On Petition to Review Decision of The Tax Court of the United States

These causes Nos. 13425 and 13426, having been called for hearing in their regular order are argued together and argument was commended by Mr. C. P. Fordyce for Joseph Sunnen, continued by Mr. Hilbert P. Zarky, Special Assistant to The Attorney General, for the Commissioner of Internal Revenue, and concluded by Mr. C. P. Fordyce for Joseph Sunnen.

Thereupon, these causes were submitted to the Court on the transcript of record from said The Tax Court of the United States and the briefs of counsel filed herein.

Opinion in Causes Nos. 13425 and 13426

United States Circuit Court of Appeals, Eighth Circuit

No. 13425

JOSEPH SUNNEN, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition to Review Decision of the Tax Court of the United States

No. 13426

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

JOSEPH SUNNEN, RESPONDENT

On Petition to Review Decision of the Tax Court of the United States

[April 28, 1947]

Mr. C. P. Fordyce for Joseph Sunnen.

Mr. Hilbert P. Zarky, Special Assistant to the Attorney General (Mr. Sewall Key, Acting Assistant Attorney General, Mr. Robert N. Anderson and Miss Helen Goodner, Special Assistants to the Attorney General, were on the brief) for Commissioner of Internal Revenue.

Before GARDNER, THOMAS, and RIDDICK, Circuit Judges.

THOMAS, Circuit Judge, delivered the opinion of the court.

These two petitions to review a single decision of the Tax Court present identical or similar questions for determination. By stipulation of the parties the cases have been consolidated here for briefing and argument and will accordingly be disposed of by us in one opinion.

The questions presented are: (1) Whether the petitioner, Joseph Sunnen, is taxable under § 22 (a) of the Revenue Act of 1936, 49 Stat. 1648, 26 U. S. C. A. Internal Revenue Acts, page 825,[1] and under § 22 (a) of the Revenue Act of 1938, 52 Stat. 447, 26 U. S. C. A. Internal Revenue Acts, page 1008, for income from certain patent license royalty contracts which he had assigned to his wife; (2) Whether a former decision of the Board of Tax Appeals involving other taxable years is res judicata as to the taxes here involved; and (3) Whether the assessments for two of the years involved were made within the time prescribed by law.

The appeal of Sunnen, the taxpayer, in No. 13425 involves deficiencies in income taxes for the years 1937 to 1941, inclusive;

[1] Section 22. Gross Income.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

Section 22 (a) of the Revenue Act of 1938 is the same.

and the appeal of the Commissioner in No. 13426 involves a deficiency for the year 1937 only.

The evidentiary facts are not in dispute. At all times material here the Sunnen Products Company, a Missouri corporation, was engaged at St. Louis, Missouri, in the manufacture and sale of patented grinding machines and other tools. The corporation had outstanding 2,000 shares of capital stock of which petitioner Joseph Sunnen, president of the company, owned 1,780 shares, Cornelia Sunnen, his wife, held 200 shares, W. A. Douglass, vice president, 19 shares, and C. J. Schuepach and R. S. Nichols, one share each. These five persons constituted the board of directors; and it was stipulated that a vote of three directors was required to make any action binding upon the Company.

Josph Sunnen was an inventor of machines for use in repairing automobiles. He applied for a patent on a "Cylinder Grinder" in 1927, a "Pinhole Grinder" in 1931, and a "Crankshaft Grinder" in 1939, on which he received patents in 1934, 1933, and 1941, respectively. He continued to own these patents through 1941. He, also, applied for a patent on an "Improved Crankshaft Grinder" in 1939, and in 1942 assigned the application to his wife Cornelia. In 1943 a patent was issued to her thereon.

After applying for patents on these several devices Sunnen entered into written contracts with the Products Company, by the terms of which he licensed the company to manufacture and sell the devices in the United States and foreign countries in consideration of a royalty of 10% of the gross sales price of the devices, to be paid to him "as the same are manufactured, sold and collected for."

The Cylinder Grinder license or royalty agreement was first executed January 10, 1928, expired January 10, 1938, and was renewed for the life of the patent which will expire on December 4, 1951. The Pinhole Grinder agreement was executed December 5, 1931, and the Crankshaft and Improved Crankshaft agreement June 20, 1931. The last two contracts were for a period of 10 years each.

Each royalty agreement contained a provision that "either party shall have the right without liability for damages or breach, to cancel this license or to increase manufacturing thereunder * * *" The original Cylinder Grinder contract required a six months' written notice of cancellation; the other contracts required one year's written notice. No notices of cancellation were given by either party during the period involved in this controversy.

After the royalty contracts were executed Sunnen assigned them to his wife Cornelia in writing and gave notice thereof to the company. Each assignment provided that "I [Joseph Sunnen] do hereby assign * * * to Cornelia Sunnen all of my right, title

and interest in and to a royalty contract this day executed" * * * etc. The assignments were gifts to the taxpayer's wife, and all gifts made after 1932 were reported for gift tax purposes.

In 1937 Mrs. Sunnen received $4,881.35 royalties from the 1928 Cylinder Grinder contract and $15,518.68 from the Pinhole Grinder contract. She received no royalties after 1937 from the original Cylinder Grinder contract; but from the 1938 renewal thereof and from the other contracts she received in 1938, $17,318.80; in 1939, $25,243.77; in 1940, $50,402.50; and in 1941, $149,002.78, all of which sums were included in her income tax returns and taxes were paid thereon. The income tax returns of petitioner Sunnen for the years 1937 and 1938 showed gross income in the respective amounts of $38,992.40 and $47,325.36.

The decision of the Tax Court in this proceeding was made March 11, 1946. In a previous proceeding involving the taxpayer's income tax liability for the years 1929, 1930, and 1931, the Board of Tax Appeals in a decision entered June 29, 1935, held that Joseph Sunnen was not liable for income taxes on the royalties paid by the Sunnen Products Company to his wife in those years under the original Cylinder Grinder license agreement of January 10, 1928, and the assignment thereof. That decision was based upon the finding that the royalty contract was an assignable property right; that the assignment vested the title to the property in the assignee; and that the license contract and not Sunnen produced the income. The Board cited as authority for its decision Nelson v. Ferguson, 3 Cir., 56 F. 2d 121, cert. den., 286 U. S. 565.

The same royalty agreement involved in the 1935 proceeding was in effect in 1937, and the Tax Court in this proceeding held that the 1935 decision is res judicata that the royalties of $4,881.35 paid thereunder to Cornelia Sunnen in 1937 are not taxable to Sunnen. The correctness of this ruling is the question here presented by the Commissioner's appeal in No. 13,426.

In the present case the Tax Court on the authority of its own decision of January 15, 1943, in Estate of J. D. Dodson, 1 T. C. 416, held that all of the royalties paid to Mrs. Sunnen under the assigned royalty contracts involved were taxable to Joseph Sunnen. The basis of the decision is that by reason of his ownership of a majority of the stock of the Sunnen Products Company, his continued ownership of the patents, and the fact that the royalty contracts were for a limited period and cancellable upon 6 months' or a year's notice, Sunnen retained such control over the income as to make him liable for the taxes thereon.

The most important question presented for determination is whether the income derived from the several royalty contracts for the use of patents and assigned without consideration by Sunnen to his wife constituted a gift of income before it was earned

and payable, and is, therefore, taxable to the donor; or, on the other hand, was it a gift of property which after the gift was complete produced income taxable to the donee. In other words, we must determine on which side of the line that separates "gifts of income-producing property and gifts of income from property of which the donor remains the owner" the income of Mrs. Sunnen from royalties falls. Harrison v. Schaffner, 312 U. S. 579, 583.

It is now quite definitely settled that an anticipatory assignment to a member of one's family of unearned wages or of the future income of property over which the assignor retains control or ownership does not shift the income tax from the assignor to the assignee. Lucas v. Earl, 281 U. S. 111; Helvering v. Clifford, 309 U. S. 331; Helvering v. Horst, 311 U. S. 112; Helvering v. Eubank, 311 U. S. 122; Harrison v. Schaffner, 312 U. S. 579. By applying the principle of these cases to the facts in the present case, the Commissioner contends that the decision of the Tax Court must be sustained. His first argument is that the patents, ownership of which was retained by Sunnen, and not the royalty contracts constitute the tree to which the fruit (income) must be attributed. We think the weight of authority is clearly to the contrary. The rule seems to be established that a royalty contract is the producing source of the royalty income and that such income is taxable to the assignee. Commissioner v. Field, 2 Cir., 42 F. 2d 820; Hall v. Burnet, App. D. C., 54 F. 2d 443, cert. den., 285 U. S. 552; Nelson v. Ferguson, 3 Cir., 56 F. 2d 121, cert. den., 286 U. S. 565; Lowery v. Helvering, 2 Cir., 70 F. 2d 713; Helvering v. Seatree, App. D. C., 72 F. 2d 67, 68; Shanley v. Bowers, 2 Cir., 81 F. 2d 13; Commissioner v. O'Donnell, 9 Cir., 90 F. 2d 907, 910, reversed on other grounds, 303 U. S. 370.

In this instance the royalty contracts are Missouri contracts and are assignable under Missouri law. Rosecrans v. William S. Lozier, Inc., 8 Cir., 142 F. 2d 118, 124; Keeley v. Indemnity Co., 222 Mo. App. 439, 7 S. W. 2d 434. The assignments are also Missouri contracts. The question of their character, validity, the nature and extent of the interest of the assignee and the powers and rights of the assignor are to be determined therefore by Missouri law. Blair v. Commissioner, 300 U. S. 5; Freuler v. Helvering, 291 U. S. 35; Eisenmenger v. Commissioner, 8 Cir., 145 F. 2d 103, 106.

The law in Missouri is the same as the law generally, namely, that an assignment of a contract without reservation vests in the assignee all the title that the assignor possessed. 6 C. J. S. Assignments § 95; Houser v. Richardson, 90 Mo. App. 134. And "The assignor, after an unqualified assignment and notice to the debtor, usually loses all control over the chose and can do nothing to defeat the rights of the assignee." 6 C. J. S. Assignments § 96;

Leahey v. Dugdale, 41 Mo. 517; Lord v. Schamdoeffel, 50 Mo. App. 360; Buffington v. South Missouri Land Co., 25 Mo. App. 492.

Unlike the transactions involved in Helvering v. Horst, supra, Harrison v. Schaffner, supra, and other cases cited supra, here the assignments of the royalty contracts were conveyances in praesenti of vested income-producing property rights. They were not mere gifts of money payable in the future from the earnings of the donor or from income-producing property owned by him. A royalty contract resembles a lease of real property and the royalties payable thereunder are analogous to rent. Had the royalty contracts not been assigned in the present case the royalties when paid to Sunnen would have been income taxable to him, the same as rents are taxable to the landlord. Burnet v. Harmel, 287 U. S. 103, 108. After the assignments the royalties were "no more the income of the donor than would be the rent from a lease or a crop raised on a farm after the leasehold or the farm had been given away." Helvering v. Horst, supra, p. 119.

The contention that the patents, ownership of which was retained by Sunnen, and not the royalty or license contracts which he assigned to his wife, produced the income is contrary to the authorities and must be rejected.

We must consider, therefore, the specific grounds upon which the Tax Court predicated its conclusion that after the assignment of the license contracts to his wife Sunnen remained the owner of the royalties for tax purposes.

The Tax Court held (1) that Sunnen at all times, notwithstanding the assignments, had the express right to cancel the royalty or license contracts, and (2) that by virtue of his position as majority stockholder of the Sunnen Products Company he had the unrestricted power to modify or abrogate the royalty contracts at any time.

The first of these conclusions is based upon the decision of the Tax Court in Estate of Dobson, 1 T. C. 416, 423, which supports the theory on the ground that Sunnen, the assignor, was a party to the license contract and that the assignee was not. This result clearly ignores the legal effect of the assignments, all of which without reservation vested in the assignee all right, title and interest of the assignor. The assignments conveyed to the assignee the right to give notice of cancellation reserved in the royalty contracts as clearly and effectually as they conveyed the right to receive the royalties when payable.

To support the second proposition that Sunnen could modify or abrogate the royalty contracts after their assignment to Mrs. Sunnen by reason of his majority interest in the capital stock of the company, the Commissioner cites the decision of this court in

Dickey v. Burnet, 8 Cir., 56 F. 2d 917. The facts in the Dickey case differed radically from the facts in the present case. There Dickey entered into a contract with the Ontario Realty Company, a corporation in which he owned a controlling interest, by the terms of which he sold to the corporation a tract of clay-producing land. The contract provided that the corporation should pay two-thirds of the gross income from the land to Dickey's wife and children. The only income of the land resulted from a contract thereafter entered into between Dickey and the corporation whereby he agreed to pay $1 a ton for the clay produced from the land for use in his several clay plants until the clay was exhausted. The latter contract was by its terms to become effective January 1, 1917, and was "to continue from year to year unless terminated by mutual agreement", and the royalty was subject to change from time to time as conditions justified. This last contract was not assigned to Dickey's wife and children. All the rights and reservations in it remained personal to Dickey. He could thus control the gross income or terminate it at any time and his wife and children, beneficiaries of the first contract, could not complain. In the instant case Sunnen retained no such powers in the royalty contracts made with the company, and he made no reservations in the assignments to his wife. The cases, therefore, are not comparable. Here the royalties were not changeable at the will of the assignor. They were fixed at 10% of the gross sales. After the assignments were made Sunnen had no power either to alter or to abrogate them.

The argument that Sunnen could so manipulate the Products Company by reason of his majority stock interest as to destroy the income covered by the assigned royalty contracts is not tenable. Neither the Tax Court nor this court should base a decision upon conjectured or possible fraud. A majority stockholder in a corporation neither owns nor directly controls the contracts or assets of the corporation. The only legitimate thing the corporation could do in this case to destroy the income from royalties would be to exercise its reserved right to cancel the contracts upon notice, as provided in each contract. On that proposition Sunnen could vote as one member of the board of five directors only. He had no plenary power as a majority stockholder even to cancel the royalty contracts. Although Sunnen was a member of the board of five directors of the Sunnen Products Company, as heretofore stated it was stipulated that the vote of three members was required to bind the company.

There is, therefore, no "warrant in the record" (Dobson v. Commissioner, supra, p. 501) to support the finding and decision of the Tax Court that Sunnen either individually or as a majority stock holder had power to destroy the income from the royalty

contracts and thus defraud the assignee. The general rule is that "In courts of law as well as those of equity, after notice to the debtor of an assignment, the interest of a bona fide assignee of a chose in action will be protected against any unauthorized act on the part o the assignor tending to interfere with the rights of the assignee. This protection extends to the nullifying of collusive agreements of the assignor and the debtor to defeat the rights of the assignee." 4 Am. Jur., Assignments, § 105. A collusive agreement, therefore, between Sunnen as majority stockholder and the Products Company to defeat the rights of Mrs. Sunnen as assignee of the royalty contracts would be illegal. Sunnen had no legal right either to cancel or to abrogate the royalty contracts or in any way to modify them before they expired by their own terms. Neither his ownership of the patents nor of the majority of the corporate stock of the Products Company enabled him to any legal way to interfere with the right of the assignee of the royalty contracts. After the assignments were made Sunnen was no longer the owner, actually or constructively, either of the contracts or of the royalties. Compare Commissioner v. Ross, 6 Cir., 83 F. 2d 18, 19; Langley v. Commissioner, 2 Cir., 61 F. 2d 796; Lum v. Commissioner, 3 Cir., 147 F. 2d 356. Under these circumstances a court of equity would protect the rights of Mrs. Sunnen against any illegal interference with such rights by Sunnen personally or by Sunnen in collusion with with Products Company. If, therefore, the finding of the Tax Court that Sunnen could control or defeat the payment of royalties to his wife be considered a finding of fact it is without "warrant in the record", and if it be regarded as a conclusion of law it is without any "reasonable basis in the law." Dobson v. Commissioner, 320 U. S. 489, 501.

Another ground relied upon by the Tax Court to support its holding that Sunnen must be regarded as the owner of the royalties provided for in the license agreements is that these agreements are "short time" contracts. It is true that short time trusts created obviously for the purpose of evading taxes do not relieve the creator of such a trust from the duty of paying taxes on the income of the corpus when control of the trust estate is reserved directly or indirectly by the trustor. That rule is not applicable here. In the instant case one of the license agreements continues during the life of the patent and the others are for 10 years each. Considering the nature of a patent license contract a 10-year license cannot fairly be said to be for so short a period as to affect the validity of the assignment thereof as a gift. Like a lease covering real estate it may be for a short or a long period, depending upon the circumstances in each case. The period of the license is a material fact in a tax case only when considered

in connection with other facts which disclose a purpose to evade taxes. Considered alone the 10-year period of the license contracts does not affect the validity of the assignments as conveyances of income-producing property and render them conveyances of the income alone. To hold otherwise requires the court to repudiate or to ignore the fundamental law of assignments stated above.

Two facts only appear in the record which the Commissioner must rely upon to support the holding of the Tax Court. They are that the assignments of the royalty contracts involved (1) constituted gifts of income-producing property, (2) from a husband to his wife, members of a family group. The Supreme Court has not held, however, nor has Congress provided by statute, that the income rom such a completed gift is taxable to the donor. All the Supreme Court has said is that any family arrangement which splits a donor's income among the members of his family requires "special scrutiny lest what is in reality but one economic unit be multiplied into two or more by devices which, though valid under State law, are not conclusive so far as § 22 (a) is concerned." Helvering 1. Clifford, supra. This is far from saying that a husband cannot by a bona fide and completed gift transfer to his wife income-producing property without thereafter being liable for Federal income taxes on subsequent earnings of the property. Where a gift is complete, without reservations and without retention of control by the donor, no decision of the Supreme Court has been called to our attention which holds the income therefrom taxable to the donor. The holding of that Court is directly to the contrary in Blair 1. Commissioner, 300 U. S. 5, at page 13.[2]

In his appeal in No. 13,426 the Commissioner contends that the Tax Court erred in holding that the decision of the Board of Tax Appeals in 1935 is res judicata as to royalties of $4,881.35 paid in 1937 to Sunnen's wife, the assignee, under the same cylinder grinder royalty agreement and the same assignment and in holding that said royalties are not taxable to Sunnen. The 1935 decision involved Sunnen's tax liability for the years 1929, 1930, and 1931. The Commissioner's specific contentions are that the principle of res judicata is not applicable (1) because in the

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[2] The Supreme Court in the Blair case said:

"The will creating the trust entitled the petitioner during his life to the net income of the property held in trust. He thus became he owner of an equitable interest in the corpus of the property. (Citations.) By virtue of that interest he was entitled to enforce the trust, o have a breach of rust enjoined and to obtain redress in case of breach. The interest was present property alienable like any other, in the absence of a valid restraint upon alienation. (Citations.) The beneficiary may thus transfer a part of his interest as well as the whole. (Citation.) The assignment of the beneficial interest is not the assignment of a chose in action but of the 'right, title and estate in and to property.' (Citations.)

"We conclude that the assignments were valid, that the assignees thereby became the owners of the specified beneficial interests in the income, and that as to these interests they and not the petitioner were taxable for the tax years in question. * * *"

interval between the 1935 decision and the decision in the present proceeding the Supreme Court has introduced "new approaches and new concepts * * * into the law of taxation" which show that the 1935 decision was clearly erroneous, and (2) for the reason that the facts and issues in the case here are not identical with the facts and issues in the former case.

In support of his first proposition the Commissioner relies upon the decision of the Supreme Court in Helvering v. Clifford, supra; Helvering v. Horst, supra; Helvering v. Eubank, supra; and Harrison v. Schaffner, supra. His contention is that under the principles of these cases Sunnen must be considered the owner for tax purposes of the royalties paid to his wife in all of the tax years, both the years 1929, 1930, and 1931, involved in the 1935 decision, and the years 1937 to 1941, inclusive, involved in this case.

It is elementary, of course, that the doctrine of res judicata is not applicable where there has been an intervening change in the controlling law. We do not think that any new principle of law controlling decision in this case was announced in the Clifford case or in the other cases cited and relied upon by the Commissioner. The principle claimed to have come into existence in these cases is that income is taxable to one as owner who controls the disposition of the income. But we have shown in the first part of this opinion that that rule or principle does not in any way affect the result in this case.

The second argument is that since income taxes are imposed on an annual basis the claim for taxes in one year is not the same cause of action as the claim for taxes in another year, that the issues are different, and therefore the rule of res judicata cannot apply.

This contention has support in some the decisions of the Federal courts, but we have no doubt that the great weight of authority is to the contrary. Tait v. Western Maryland R. Co., 289 U. S. 620; Southern Pacific R. Co. v. United States, 168 U. S. 1, 48; Montgomery v. Thomas, Collector, 5 Cir., 146 F. 2d 76, 79, 80; Gillespie v. Commissioner, 10 Cir., 151 F. 2d 903, 906; Cory v. Commissioner, 3 Cir., 159 F. 2d 390, and authorities cited; and Bennett v. Commissioner, 5 Cir., 113 F. 2d 837.

One of Sunnen's contentions is that the decision of the Board of Tax Appeals in 1935 is res judicata or within the principle of stare decisis in respect of all the taxes here in controversy. This proceeding, however, involves not only taxes for different years but with the exception of the 1937 royalties produced by the 1928 contract, it involves different royalties from different royalty contracts for use of different patents. It is true that there is a common relation between the two proceedings. The parties are

the same in each case and the questions to be determined are the same. In view of our decision on the merits, however, it is unnecessary to determine this contention.

Our conclusions with reference to the first two questions presented for determination make it unnecessary to consider whether the deficiencies for the years 1937 and 1938 were determined by the Commissioner within the time prescribed by law.

The decision of the Tax Court in No. 13,425, involving the petition of Joseph Sunnen, is reversed, and the decision assailed by the Commissioner in No. 13,426 is affirmed.

A true copy.

Attest:

[SEAL] E. E. KOCH,

Clerk, U. S. Circuit Court of Appeals, Eighth Circuit.

Judgment in Causes Nos. 13425 and 13426

United States Circuit Court of Appeals, Eighth Circuit

March Term, 1947

Monday, April 28, 1947

No. 13425

JOSEPH SUNNEN, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE

On Petition to Review Decision of The Tax Court of the United States

and

No. 13426

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

JOSEPH SUNNEN

On Petition to Review Decision of The Tax Court of the United States

These causes came on to be heard on the transcript of the record from The Tax Court of the United States, and were argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the decision of the Tax Court in these causes involving the petition of Joseph Sunnen to review be, and is hereby, reversed, and the decision of the Tax Court assailed by the Commissioner of Internal Revenue be, and is hereby, affirmed.

APRIL 28, 1947.

Clerk's Certificate

United States Circuit Court of Appeals, Eighth Circuit

I, E. E. Koch, Clerk of the United States Circuit Court of Appeals for the Eighth Circuit, do hereby certify that the foregoing contains the transcript of record on petitions to review the decision of The Tax Court of the United States, as prepared and printed under the rules of the United States Circuit Court of Appeals for the Eighth Circuit, under the supervision of its Clerk, and full, true and complete copies of the pleadings, record entries and proceedings, including the opinion, had and filed in the United States Circuit Court of Appeals, except the full captions, titles and endorsements omitted in pursuance of the rules of the Supreme Court of the United States, in certain causes in said Circuit Court of Appeals wherein Joseph Sunnen was Petitioner and the Commissioner of Internal Revenue was Respondent, No. 13425, and the Commissioner of Internal Revenue was Petitioner and Joseph Sunnen was Respondent, No. 13426, as full, true and complete as the originals of the same remain on file and of record in my office.

I do further certify that on the 19th day of May A. D. 1947, a mandate was issued out of said Circuit Court of Appeals in said causes, directed to The Tax Court of the United States.

In Testimony Whereof, I hereunder subscribe my name and affix the seal of the United States Circuit Court of Appeals for the Eighth Circuit, at office in the City of St. Louis, Missouri, this 21st day of July A. D. 1947.

[SEAL]

E. E. KOCH,
Clerk of the United States Circuit Court of Appeals, Eighth Circuit.

U. S. GOVERNMENT PRINTING OFFICE: 1947

Supreme Court of the United States

Order allowing certiorari

Filed October 13, 1947

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit is granted, and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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Office - Supreme Court, U. S.
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CHARLES ELMORE CROPLEY

No. 227

In the Supreme Court of the United States

OCTOBER TERM, 1947

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

JOSEPH SUNNEN

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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In the Supreme Court of the United States

OCTOBER TERM, 1947

No. 227

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

JOSEPH SUNNEN

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

The Acting Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Eighth Circuit entered in the above case on April 28, 1947.

OPINION BELOW

The opinion of the Tax Court (R. 62–72) is reported at 6 T. C. 431, and the opinion of the Circuit Court of Appeals (R. 92) is reported at 161 F. 2d 171.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 28, 1947 (R. 101). The jurisdiction of this Court is invoked under Section

240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer assigned to his wife his interest in contracts under which his controlled corporation agreed to pay him royalties in return for nonexclusive and mutually cancellable licenses to manufacture and sell certain patented devices; the ownership of the patents was retained by him. The question is whether the Circuit Court of Appeals erred in reversing the decision of the Tax Court, entered pursuant to its finding that the royalties paid to the taxpayer's wife under these assignments in the taxable years 1937–41, inclusive (except for a small amount held excludible under the doctrine of *res judicata*), were in fact the taxable income of the taxpayer in those years.

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition.* — "Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any

business carried on for gain or profit, or gains or profits and income derived from any source whatever * * * (26 U. S. C. 1940 ed., Sec. 22).

SEC. 1141. COURTS OF REVIEW.

(a) *Jurisdiction.*—The Circuit Courts of Appeals and the United States Court of Appeals for the District of Columbia shall have exclusive jurisdiction to review the decisions of the Board,[1] except as provided in section 239 of the Judicial Code, as amended, 43 Stat. 938 (U. S. C., Title 28, § 346); and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 240 of the Judicial Code, as amended, 43 Stat. 938 (U. S. C., Title 28, § 347).

* * * * *

(c) *Powers.*—

(1) *To affirm, modify, or reverse.*—Upon such review, such courts shall have power to affirm, or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require (26 U. S. C. 1940 ed., Sec. 1141).

(Section 22 (a) of the Revenue Acts of 1938, c. 289, 52 Stat. 447, and of 1936, c. 690, 49 Stat. 1648,

[1] The name of the Board of Tax Appeals was changed to that of The Tax Court of the United States by Section 504 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798.

is the same as Section 22 (a) of the Internal Revenue Code.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

> SEC. 19.22 (a)–1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. Profits of citizens, residents, or domestic corporations derived from sales in foreign commerce must be included in their gross income; but special provisions are made for nonresident aliens and foreign corporations by sections 211 to 238, inclusive, and, in certain cases, by section 251, for citizens and domestic corporations deriving income from sources within possessions of the United States.. Income may be in the form of cash or property.
>
> * * * * *

Article 22 (a)–1 of Treasury Regulations 101, promulgated under the Revenue Act of 1938, and Article 22 (a)–1 of Treasury Regulations 94, pro-

mulgated under the Revenue Act of 1936, are the same.

STATEMENT

The material facts in this case were stipulated (R. 25–50) and were so found by the Tax Court (R. 63). Their statement by the Tax Court (R. 63–69) may be summarized as follows:

During the taxable years Sunnen Products Company, a Missouri corporation (hereinafter referred to as "Company"), was engaged in the manufacture and sale of patented grinding machines and other tools. The taxpayer, a resident of Clayton, Missouri, held 1,780 out of a total of 2,000 shares of the Company's stock; his wife, Cornelia Sunnen, held 200 shares; and others connected with the Company held the remaining 20 shares. The Company's board of directors consisted of five members, including the taxpayer and his wife, and a vote of three was required to take binding action (R. 63–64, 66). It was stipulated that the directors were elected by the stockholders annually (R. 31–32).

In 1927, 1931 and 1939 the taxpayer, an inventor, had applied for patents on a cylinder grinder device, a pinhole grinder device, and a crankshaft grinder device, and subsequently patents were issued to him. He remained the owner of these patents through the year 1941. In 1939 the taxpayer applied for a patent on another crankshaft grinder device, and remained the owner of the application through the year 1941. (R. 64.)

By a written agreement dated January 10, 1928, the taxpayer granted the Company the right, license and privilege to manufacture and sell in the United States and foreign countries the "cylinder grinders" device, on which he had applied for a patent. In consideration of this license the Company agreed to pay to the taxpayer a royalty equal to 10% of the gross sales price of the device as it was "manufactured, sold and collected for." Both parties were given the right to cancel the license or to cease manufacturing thereunder, without liability, upon six months' notice in writing to the other party. In the absence of cancellation, the agreement was to continue in force for ten years (R. 64–65). Upon the expiration of this agreement in 1938, a renewal agreement with substantially the same terms was executed pursuant to which the Company was licensed to manufacture and sell the cylinder grinder for the balance of the life of the patent, i. e., until December 4, 1951 (R. 66).

Similar licensing agreements, except that the period for serving notice of cancellation was one year instead of six months, were executed by the taxpayer and the Company on December 5, 1931, with respect to the pinhole grinder device, and on June 20, 1939, with respect to the two crankshaft grinder devices. The Company was authorized by its board of directors to execute each of the license agreements (R. 64, 65, 66).

No notices of cancellation were given and all the licensing agreements remained in effect throughout the taxable years 1937–1941, inclusive, in accordance with their terms (R. 66).

On January 8, 1929, the taxpayer assigned to his wife "all my rights, title and interest in and to the Royalty which shall accrue hereafter to me" upon the royalty contract of January 10, 1928, with respect to the cylinder grinder device. On January 15, 1929, he advised the Company of the assignment (R. 66–67). On December 21, 1931, he executed a further assignment which recited that the Commissioner of Internal Revenue had raised some question as to the sufficiency and completeness of the previous assignment, and in which he confirmed the previous assignment, and assigned to his wife (R. 67–68)—

> all of my right, title and interest in and to said royalty contract of January 10, 1928 between myself and said Sunnen Products Company, relating to the manufacture of the cylinder grinder described in said royalty contract, for the calendar year 1931, particularly. And I hereby state that the royalties accruing under said royalty contract have heretofore been and are hereafter the sole and exclusive property of the said Cornelia Sunnen, and hereby declare that said royalties shall be paid to the said Cornelia Sunnen or to her order, and that she shall have the sole right to

collect, receive, receipt for, retain or sue for said royalties.

The taxpayer also executed written assignments, similar in form and substance to the assignment of December 21, 1931, purporting to assign all of his right, title, and interest in and to the royalty contracts with respect to the pinhole grinder and the two crankshaft grinders, and to the renewal royalty contract made in 1938 with respect to the cylinder grinder. In each case he notified the Company of the assignments (R. 68).

All the assignments were without consideration and were made as gifts to taxpayer's wife. The gifts made after 1932 were reported by taxpayer for gift tax purposes (R. 68).

In 1937 the Company paid to taxpayer's wife, pursuant to the assignments, royalties on the 1928 cylinder grinder contract in the amount of $4,881.35 and on the pinhole grinder license contract royalties of $15,518.68. In the taxable years 1938–1941, inclusive, no royalties were paid on the 1928 cylinder grinder contract, but royalties were paid to taxpayer's wife on the 1938 renewal cylinder grinder contract and on the pinhole and crankshaft grinder contracts in the total amounts of $17,318.80 in 1938, $25,243.77 in 1939, $50,492.50 in 1940, and $149,002.78 in 1941 (R. 68).

The taxpayer's wife included as her income on tax returns all of the royalties paid to her in the taxable years in which she received them. She

paid income taxes thereon, which have not been refunded to her (R. 69).

The taxpayer's returns for 1937, 1938, 1939, 1940, and 1941 reported net income of $30,616.03, $36,787.82, $42,229.35, $48,846.92, and $60,570.28, respectively (R. 13–17).

In a previous proceeding involving the taxpayer's income tax liability for the years 1929, 1930, and 1931, the Board of Tax Appeals held that the taxpayer was not taxable on the royalties paid to his wife in those years under the original license agreement of January 10, 1928, with respect to the cylinder grinder device (R. 53–60). It was stipulated that this opinion, and decisions rendered pursuant thereto, might be considered in this case to the same extent as if introduced in evidence (R. 69).

Upon these facts the Tax Court, one judge dissenting, held that all of the royalties paid to taxpayer's wife in each taxable year under the license agreements were in fact taxable income of the taxpayer, with the exception that the royalties of $4,881.35 paid in 1937 under the original cylinder grinder license contract were held to be excludable from his income in that year. This was on the theory that the principle of *res judicata* prevented treating these royalties as taxable income of the taxpayer in 1937, since in the former decision the Board had held that royalties paid under the same contract in the years 1929, 1930, and 1931 were not income of the taxpayer (R. 69–72).

The taxpayer appealed to the Circuit Court of Appeals, contending (1) that the Tax Court erroneously decided that the royalties paid to his wife in the taxable years under the license agreements constituted taxable income in fact to him; and (2) that the Tax Court erred in failing to hold that the former decision of the Board was *res judicata* that none of the royalties were taxable income to him in any taxable year. The Commissioner also appealed to the Circuit Court of Appeals from the portion of the Tax Court's decision which was adverse to him, contending that the Tax Court was not estopped by the doctrine of *res judicata* from including the royalties of $4,881.35, paid under the 1928 licensing contract, in taxpayer's income for 1937 (R. 80–82).

The Circuit Court of Appeals reversed the Tax Court's decision on the merits in the taxpayer's appeal, holding that the royalties paid to the taxpayer's wife in the taxable years were not income to the taxpayer (R. 92–99). In the Commissioner's appeal, the Circuit Court of Appeals affirmed the Tax Court, holding that the doctrine of *res judicata* prevented inclusion in taxpayer's income of the royalties of $4,881.35 paid in 1937 under the original cylinder grinder royalty contract (R. 99–100). In view of its decision on the merits, it was unnecessary for the court to decide the applicability of *res judicata* to the other royalties paid in the taxable years (R. 100–101).

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In holding that the royalties paid to the taxpayer's wife were not in fact taxable income of the taxpayer in the taxable years, and in substituting its view for that of the Tax Court.

2. In holding that the principle of *res judicata* prevents taxation of the royalties of $4,881.35 paid in 1937 under the original cylinder grinder license contract to the taxpayer.[2]

REASONS FOR GRANTING THE WRIT

1. The decision of the Circuit Court of Appeals is in conflict with principles established in decisions of this Court. One who assigns the right to receive income, but retains ownership of the property producing that income, is, despite the assignment, taxable on the income when paid to his assignee. *Helvering* v. *Horst,* 311 U. S. 112; *Helvering* v. *Eubank,* 311 U. S. 122; *Harrison* v. *Schaffner,* 312 U. S. 579; *United States* v. *Joliet & Chicago R. Co.,* 315 U. S. 44; *Commissioner* v. *Tower,* 327 U. S. 280; *Lusthaus* v. *Commissioner,* 327 U. S. 293; *Lucas* v. *Earl,* 281 U. S. 111; *Burnet* v. *Leininger,* 285 U. S. 136; *Commissioner* v. *Harmon,* 323 U. S. 44. And the result is the same for tax purposes, even though

[2] This second error is not urged as a reason for granting certiorari, but it is set out here so that the Government will not be foreclosed from arguing if in the event a writ of certiorari is granted.

a legally perfect gift of income producing property has been made, where the transfer is an intrafamily arrangement leaving the assignor with incidents of control sufficient to support the conclusion that he is in substance the true owner of the property. *Helvering* v. *Clifford*, 309 U. S. 331; *Helvering* v. *Horst*, *supra*, pp. 116–117; *Harrison* v. *Schaffner*, *supra*, pp. 583, 584; *Commissioner* v. *Tower*, *supra*; *Lusthaus* v. *Commissioner*, *supra*; cf. *Burnet* v. *Wells*, 289 U. S. 670.

The facts of this case fit within these principles, as the Tax Court held. The royalties were paid for the nonexclusive privilege of manufacturing and selling certain patented devices, and the royalties were thus derived from the patents which taxpayer continued to own. The license contracts only fixed the amount of the income which would be earned by use of the patents. But even if the license agreements are regarded as property contributing to the production of the royalty income, the patents themselves cannot be wholly ignored as the substantial source of the royalties.[3]

[3] No case of which we are aware holds that the royalty contract in a situation of this kind is the exclusive source of the royalties. In *Washington* v. *Commissioner*, 80 F. 2d 829 (C. C. A. 2d), certiorari denied, 298 U. S. 689, and in *Estate of Dodson* v. *Commissioner*, 1 T. C. 416, dismissed September 1, 1943 (C. C. A. 5), it was assumed without deciding that this was so, but the assignor's control in connection with the contracts themselves compelled the conclusion that he was their substantial owner in those cases. The lower court, however, held (R. 95–96) that the royalty or

As in *Helvering* v. *Horst, supra,* which involved the assignment of interest coupons, the gift of a separate contractual right to payment of the income does not, where ownership of the basic property is retained, shift tax responsibility under Section 22 (a) of the Internal Revenue Code, *supra,* on the income to the assignee.[4] Clearly taxpayer would have been taxable if he had assigned the royalties themselves to his wife. The consequence should not be different because he achieves the same result by entering into con-

license contracts, and not the patents, produced the income, citing seven cases (R. 95) as authority. We think that none of these cases, assuming they were correctly decided, support the holding. The only one of them which involved an assigned patent royalty contract is *Nelson* v. *Ferguson*, 56 F. 2d 121 (C. C. A. 3), certiorari denied, 286 U. S. 565. That decision seems erroneous under subsequent decisions of this Court, but in any case there the patents themselves were transferred to a corporation, without right to sell, for exploitation in consideration of one-third of the net profits to be realized therefrom. Thus, it is unlike the present case wherein taxpayer retained the patents and nothing more than a cancellable, nonexclusive license to manufacture and sell was granted to the Company.

[4] In this connection, it is significant that, apart from a possible right to cancel the contracts if taxpayer's personal right to do so upon giving the prescribed notice passed to her, taxpayer's wife had no rights other than to collect and receive such royalties as became payable under the contracts. The license contracts do not require the Company to manufacture and sell any particular number of devices, and do not specify minimum royalties payable (R. 33–34, 36–37, 39–41, 43–44). Thus, they do not guarantee that the licensor or his assignee will receive a minimum, or indeed any, royalties from the licensee.

tracts for royalties with a family corporation, and then assigns the contracts.

The Tax Court's conclusion that the royalties were in fact the income of the taxpayer took into account not only his ownership of the patents, a point which it stressed (R. 72), but also his powers of control over the license contracts and the flow of income thereunder. On the facts as a whole its conclusion was the only one reasonably possible. As president of the Company and owner of 89% of its stock, and as owner of the patents, with rights *inter alia* to use them himself, to license others than the Company to do so, and to protect them against infringement, the taxpayer retained the power to regulate the Company's production and sales and to create competition with it; he thus controlled, even to the point of terminating, the royalties payable by the Company. Furthermore, his controlled corporation was authorized by the contracts to cancel the license on a year or six months' notice, thus empowering him to divest even the legal title of the assignee to the royalty rights.[5] Cf. *Corliss* v.

[5] The Circuit Court of Appeals improperly assumed that the powers of control were not substantial, on the theory that an attempted exercise of the powers would necessarily amount to a fraud on the Company or on the taxpayer's assignee, which would be enjoined or would inevitably be defeated by the other directors of the Company. The taxpayer might have caused a cancellation of the old contracts and have substituted new ones with more favorable terms to the Company; there would be no fraud on the Company in such case. More-

Bowers, 281 U. S. 376. Coupled with ownership of the patents and these powers of control are the circumstances that the licenses were of a temporary character; that the wife acquired in substance nothing more than the right to take the royalties; that the arrangement was a device to reallocate some of the husband's income to his wife for tax purposes (see R. 67), and that the assignments effect no material alteration of his economic status, the income all remaining in the close family group. Viewed realistically, the facts as a whole require the conclusion that the taxpayer was in every practical and substantial sense the owner of the entire interest in the property which produced the income.

The rule of *Blair* v. *Commissioner*, 300 U. S. 5, which the Circuit Court of Appeals followed, does not apply because there, as the Court pointed out, the donor assigned completely specified parts of

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over, the assignee would have no standing to complain of cancellation since her contractual rights were subject to the Company's right to cancel upon notice without incurring liability. Even if it is assumed, despite the apparently harmonious family relationship, that the taxpayer's wife as a director would vote contrary to his wishes, it may not be assumed that the other directors of the Company were not amenable to his will, particularly since the directors were elected annually by the stockholders (R. 31–32), and a recalcitrant director could thus be removed by the taxpayer, the controlling stockholder. Further, it seems undoubted that the taxpayer's rights as owner of the patents could be exercised without interference, since the Company had only non-exclusive licenses.

an equitable interest owned by him. Cf. *Harrison* v. *Schaffner, supra.* Here, the taxpayer's rights to his patents were not covered by the license agreements, and hence were not assigned. Nor is the lower court's analogy of an assignment of a lessor's interest in a lease (R. 96) entirely apposite here. We believe that the illustration given in *Helvering* v. *Horst, supra,* p. 119, refers to an assignment of his entire interest by the owner of only a leasehold.[6] Here, the taxpayer did not dispose of all of his present rights in the patents and he clearly should be taxable on the assigned royalties, as is the lessor of an easement, who has retained the right to grant to others use of the easement, taxable on the rents assigned to another. Cf. *Ward* v. *Commissioner,* 58 F. 2d 757 (C. C. A. 9), certiorari denied, 287 U. S. 656.

2. The judgment of the Circuit Court of Appeals reflects a clear abuse of the court's power of review under Section 1141 (c) (1) of the Internal Revenue Code, *supra,* and violates numerous decisions of this Court delineating the circumstances in which the Tax Court may be reversed.

[6] But even where a lessor owns a fee in the realty, he ordinarily has leased all of his present rights in the property or in a severable part thereof, and in such case a purported assignment of his interest in the leasehold has been held to carry with it the liability for tax on the rents. *Lum* v. *Commissioner,* 147 F. 2d 356 (C. C. A. 3), a case we believe to have been incorrectly decided, which illustrates the potentialities for tax avoidance of a scheme comparable to that involved here.

See *Commissioner* v. *Tower,* 327 U. S. 280; *John Kelley Co.* v. *Commissioner,* 326 U. S. 521; *Commissioner* v. *Court Holding Co.,* 324 U. S. 331; *Commissioner* v. *Scottish American Co.,* 323 U. S. 119; *Dobson* v. *Commissioner,* 320 U. S. 489, rehearing denied, 321 U. S. 231; *Helvering* v. *Stock Yards Co.,* 318 U. S. 693. Whether the bundle of rights resting in a donor invests him with sufficient powers of control to justify treating him for tax purposes as the substantial owner of the property and the income therefrom, despite the transfer of legal title to an assignee, does not present any "clear-cut question of law", but is one for the trier of the facts. *Helvering* v. *Clifford,* 309 U. S. 331, 336; *Helvering* v. *Stuart,* 317 U. S. 154, 169. Other Circuit Courts of Appeals have treated the question of whether the income is still attributable to the donor as a question of fact for the Tax Court. *Hash* v. *Commissioner,* 152 F. 2d 722 (C. C. A. 4); *Eisenberg* v. *Commissioner,* 161 F. 2d 506 (C. C. A. 3), certiorari applied for, No. 221, this Term; *Littel* v. *Commissioner,* 154 F. 2d 922 (C. C. A. 2). While the issue as to the real ownership of the income here turns on the ownership of the income-producing property, as well as on the donor's powers of control, it was plainly the Tax Court's function to weigh the facts and draw the conclusion. Cf. *Helvering* v. *Horst, supra; Commissioner* v. *Tower, supra.*

As we have shown, the Tax Court's finding that the royalties were in fact taxable income of the taxpayer has substantial support in, if it was not compelled by, the record facts. The finding was made with a correct understanding of the controlling legal principles. In these circumstances it was serious error for the Circuit Court of Appeals to substitute its own factual conclusion for that of the Tax Court.

3. The question presented in this case is an important one and should be settled by this Court. The method used by the taxpayer here to shift some of his income to his wife is adaptable to virtually every kind of property interest which may be licensed or leased, and, if successful taxwise, is likely to stimulate comparable plans to avoid taxes.

CONCLUSION

For the foregoing reasons it is respectfully submitted that the petition for a writ of certiorari should be granted.

GEORGE T. WASHINGTON,
Acting Solicitor General.

JULY 1947.

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No. 227

In the Supreme Court of the United States

OCTOBER TERM, 1947

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

JOSEPH SUNNEN

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE PETITIONER

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COMMISSIONER OF INTERNAL REVENUE, PETITIONER

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the Tax Court (R. 62–72) is reported at 6 T. C. 431. The opinion of the Circuit Court of Appeals (R. 92–101) is reported at 161 F. 2d 171.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 28, 1947. (R. 101–102.) The petition for a writ of certiorari was filed on July 28, 1947, and was granted on October 13, 1947. (R. 103.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

Mr. Sunnen is an inventor who had obtained certain patents; he is also the owner of 89% of the stock of a manufacturing corporation, and his wife owns 10% of the stock. In exchange for a specified royalty, he gave the corporation non-exclusive licenses to manufacture and sell devices covered by the patents. The licenses were cancellable by either party upon giving appropriate notice. He assigned his interest in the royalty agreements to his wife. The Tax Court held that he was not relieved of tax with respect to the royalties paid to his wife under the assignments in the taxable years 1937–1941 (except for a small amount in 1937 held excludible under the doctrine of *res judicata*).

1. The principal question presented is whether the Circuit Court of Appeals was warranted in holding that Mr. Sunnen could effectively avoid the tax upon the royalties through such assignments.

2. A subsidiary question that may be raised by the taxpayer is whether an earlier decision of the Board of Tax Appeals (involving a similar royalty agreement and assignment) should be treated as conclusive of the entire controversy under the doctrine of *res judicata*.

STATUTES AND REGULATIONS INVOLVED

These are set out in the Appendix, *infra*, pp. 30–32.

STATEMENT

The material facts in this case were stipulated (R. 25–50) and were so found by the Tax Court (R. 63). Their statement by the Tax Court (R. 63–69) may be summarized as follows:

During the taxable years, 1937–1941, Sunnen Products Company, a Missouri corporation, was engaged in the manufacture and sale of patented grinding machines and other tools. The taxpayer, a resident of Clayton, Missouri, held 1,780 out of a total of 2,000 shares of the Company's outstanding stock; his wife, Cornelia Sunnen, held 200 shares; and others connected with the Company held the remaining 20 shares. (R. 63–64.) The Company's board of directors consisted of five members, including the taxpayer and his wife, and a vote of three was required to take binding action. (R. 66.) It was stipulated that the directors were elected by the stockholders annually. (R. 31–32.)

In 1927, 1931 and 1939 the taxpayer, an inventor, had applied for patents on a cylinder grinder device, a pinhole grinder device, and a crankshaft grinder device, and subsequently patents were issued to him. He remained the owner of these patents through the year 1941. In 1939 the taxpayer applied for a patent on another crankshaft grinder device, and remained the owner of the application through the year 1941. (R. 64.)

By a written agreement dated January 10, 1928, the taxpayer granted the Company the right, license and privilege to manufacture and sell in the United States and foreign countries the "cylinder grinders" device, on which he had applied for a patent. In consideration of this license the Company agreed to pay to the taxpayer a royalty equal to 10% of the gross sales price of the device as it was "manufactured, sold and collected for." Both parties were given the right to cancel the license or to cease manufacturing thereunder, without liability, upon six months' notice in writing to the other party. In the absence of cancellation, the agreement was to continue in force for ten years. (R. 64–65.) Upon the expiration of this agreement in 1938, a renewal agreement with substantially the same terms was executed pursuant to which the Company was licensed to manufacture and sell the cylinder grinder for the balance of the life of the patent, i. e., until December 4, 1951. (R. 66.)

Similar licensing agreements, except that the period for serving notice of cancellation was one year instead of six months, were executed by the taxpayer and the Company on December 5, 1931, with respect to the pinhole grinder device, and on June 20, 1939, with respect to the two crankshaft grinder devices. The Company was authorized by its board of directors to execute each of the license agreements. (R. 64, 65, 66.)

No notices of cancellation were given and all the licensing agreements remained in effect throughout the taxable years 1937–1941, inclusive, in accordance with their terms. (R. 66.)

On January 8, 1929, the taxpayer assigned to his wife, "all my rights, title and interest in and to the Royalty which shall accrue hereafter to me" upon the royalty contract of January 10, 1928, with respect to the cylinder grinder device. On January 15, 1929, he advised the Company of the assignment. (R. 66–67.) On December 21, 1931, he executed a further assignment which recited that the Commissioner of Internal Revenue had raised some question as to the sufficiency and completeness of the previous assignment, and in which he confirmed the previous assignment, and assigned to his wife (R. 67–68)—

> all of my right, title and interest in and to said royalty contract of January 10, 1928 between myself and said Sunnen Products Company, relating to the manufacture of the cylinder grinder described in said royalty contract, for the calendar year 1931, particularly. And I hereby state that the royalties accruing under said royalty contract have heretofore been and are hereafter the sole and exclusive property of the said Cornelia Sunnen, and hereby declare that said royalties shall be paid to the said Cornelia Sunnen or to her order, and that she shall have the sole right to collect, receive, receipt for, retain or sue for said royalties.

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The taxpayer also executed written assignments, similar in form and substance to the assignment of December 21, 1931; purporting to assign all of his right, title, and interest in and to the royalty contracts with respect to the pinhole grinder and the two crankshaft grinders, and to the renewal royalty contract made in 1938 with respect to the cylinder grinder. In each case he notified the Company of the assignments. (R. 68).

All the assignments were without consideration and were made as gifts to taxpayer's wife. The gifts made after 1932 were reported by taxpayer for gift tax purposes. (R. 68.)

In 1937 the Company paid to taxpayer's wife, pursuant to the assignments, royalties on the 1928 cylinder grinder contract in the amount of $4,881.35 and on the pinhole grinder license contract royalties of $15,518.68. In the taxable years 1938–1941, inclusive, no royalties were paid on the 1928 cylinder grinder contract, but royalties were paid to taxpayer's wife on the 1938 renewal cylinder grinder contract and on the pinhole and crankshaft grinder contracts in the total amounts of $17,318.80 in 1938, $25,243.77 in 1939, $50,492.50 in 1940, and $149,002.78 in 1941. (R. 68.)

The taxpayer's wife included in her income tax returns all of the royalties paid to her in the taxable years in which she received them. She paid income taxes thereon, which have not been refunded to her. (R. 69.)

The taxpayer in his returns for 1937, 1938, 1939, 1940, and 1941, reported net income of $30,616.03, $36,787.82, $42,229.35, $48,846.92, and $60,570.28, respectively. (R. 13–17.)

In a previous proceeding involving the taxpayer's income tax liability for the years 1929, 1930, and 1931, the Board of Tax Appeals held that the taxpayer was not taxable on the royalties paid to his wife in those years under the original license agreement of January 10, 1928, with respect to the cylinder grinder device. (R. 53–62.) It was stipulated that this opinion, and decisions rendered pursuant thereto, might be considered in this case to the same extent as if introduced in evidence. (R. 69.)

Upon these facts the Tax Court, one judge dissenting, held that all of the royalties paid to taxpayer's wife in each taxable year under the license agreements were in fact taxable income of the taxpayer, with the exception that the royalties of $4,881.35 paid in 1937 under the original cylinder grinder license contract were held to be excludible from his income in that year. This was on the theory that the principle of *res judicata* prevented treating these royalties as taxable income of the taxpayer in 1937, since in the former decision the Board had held that royalties paid under the same contract in the years 1929, 1930, and 1931, were not income of the taxpayer. (R. 69–72.)

The taxpayer appealed to the Circuit Court of Appeals, contending (1) that the Tax Court erroneously decided that the royalties paid to his wife in the taxable years under the license agreements constituted taxable income in fact to him; and (2) that the Tax Court erred in failing to hold that the former decision of the Board was *res judicata* that none of the royalties were taxable income to him in any taxable year. (R. 73–80.) The Commissioner also appealed to the Circuit Court of Appeals from the portion of the Tax Court's decision which was adverse to him, contending that the Tax Court was not estopped by the doctrine of *res judicata* from including the royalties of $4,881.35, paid under the 1928 licensing contract, in taxpayer's income for 1937. (R. 80–82.)

The Circuit Court of Appeals reversed the Tax Court's decision on the merits in the taxpayer's appeal, holding that the royalties paid to the taxpayer's wife in the taxable years were not income to the taxpayer. (R. 92–99.) In the Commissioner's appeal, the Circuit Court of Appeals affirmed the Tax Court, holding that the doctrine of *res judicata* prevented inclusion in taxpayer's income of the royalties of $4,881.35 paid in 1937 under the original cylinder grinder royalty contract. (R. 99–100.) In view of its decision on the merits, it was unnecessary for the court to decide the question raised by the taxpayer as to

the applicability of *res judicata* to the other royalties paid in the taxable years. (R. 100–101.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

(1) In not holding that the royalties paid to the taxpayer's wife were in fact taxable income of the taxpayer.

(2) In substituting its view for that of the Tax Court and reversing the Tax Court's decision.

SUMMARY OF ARGUMENT

I

The basic question presented is whether the owner of a patent who has granted to his controlled corporation a non-exclusive and cancellable license to exploit it for a limited period, in consideration of royalties to be paid him, may, by assigning his interest in the license contract to his wife, shift to her the responsibility for income taxes on the royalties thereafter paid to her under the assignment. We submit that he cannot. The Tax Court correctly so held and specifically found that the royalties paid to the wife were in fact taxable income of the husband. The result thus reached was in accord with established principles. *Lucas* v. *Earl*, 281 U. S. 111; *Helvering* v. *Horst*, 311 U. S. 112; *Helvering* v. *Eubank*, 311 U. S. 122; *Harrison* v. *Shaffner*, 312 U. S. 579; *Helvering* v. *Clifford*, 309 U. S. 331; *Commissioner* v. *Tower*, 327 U. S. 280. We submit that the Tax

Court's decision should not have been reversed by the Circuit Court of Appeals.

The Circuit Court of Appeals failed to focus attention on the overall picture, the composite of the incidents of ownership and control that taxpayer retained. It treated the royalty agreements as the sole source of the income involved, and concluded that since the taxpayer had given away the source he could no longer be held accountable for the income therefrom. But the court erred in thus isolating the royalty agreements. In every real sense the inventions and the patents themselves, rather than the royalty agreements, were the underlying source of the income, and these the taxpayer retained for himself. Moreover, the license and royalty agreements were cancellable, and the taxpayer, as president, director, and majority stockholder of the corporation-licensee was in a position to control its policies and actions. Furthermore, since the licenses here involved were non-exclusive, the taxpayer as owner of the patents could have granted licenses to others (including licenses to any wholly-owned corporation that he might choose to organize for that purpose) and thus divert the business from the first licensee. In the circumstances, it cannot be said that the taxpayer made an outright gift to his wife, without reservations and without retention of control, so that she and not he would be accountable for the future income from the property.

If taxpayer had assigned the patent royalties alone, or the future income from the patents which he owned, he would clearly be taxable regardless of the assignment and we submit that no different result is justified here because he undertook to assign the royalty contracts themselves. It seems plain that the inventions and the patents, and not the royalty contracts, were the essential source of the income, and taxpayer retained ownership of such source. Moreover, even if the contracts be considered as the main source of the income, taxpayer's retained controls over them would still be enough to justify the tax.

Although this case involves legal principles of sufficient generality as ordinarily to render inapplicable the rule of *Dobson* v. *Commissioner*, 320 U. S. 489, those principles have already been established by the decisions of this Court in such cases as *Lucas* v. *Earl*, and the *Horst*, *Eubank*, *Shaffner*, *Clifford*, and *Tower* cases; accordingly, it would seem that the reasonable application of those principles by the Tax Court to the facts of this case should have been left undisturbed by the court below under the *Dobson* rule.

II

There is no basis for the application of *res judicata* here. The royalty agreements and assignments in this case are wholly separate and distinct from the royalty agreement and assignment involved in the earlier case. The principle of *res*

judicata is one that forbids inquiry into the truth and prevents the correct disposition of a controversy. It does not rest upon any statutory basis in federal tax cases, and is applied sparingly in situations involving different tax periods. It is not enough that the facts in the second period be "similar" to those involved in the prior adjudication; the courts have insisted that the liability in the second period must have its roots in the identical factual situation that was before the adjudicating body in the first proceeding.

A second reason why *res judicata* is inapplicable is that, after the decision of the Board of Tax Appeals in the earlier proceedings, a number of decisions of this Court (*e. g.*, in the *Horst, Eubank, Shaffner, Clifford,* and *Tower* cases) have been rendered which develop and make clear the underlying principles to be applied in cases of this type. And it has frequently been recognized in tax cases involving different periods that *res judicata,* which forecloses inquiry into the correct disposition of a controversy, is not operative where there have been authoritative intervening decisions with respect to controlling legal principles.

ARGUMENT

I

THE INCOME IN QUESTION IS TAXABLE TO THE ASSIGNOR

This case presents a situation where the taxpayer, an inventor, granted to a corporation of

which he was president and controlling stockholder nonexclusive and cancellable licenses to exploit for a limited number of years certain patents which he owned; and in return for that privilege the corporation agreed to pay to the taxpayer royalties amounting to ten percent of the gross sales. He then assigned his interest in the contracts to his wife and the question is whether he or she should be taxed upon the royalties paid by the corporation to the wife after the contracts were assigned.

The Tax Court ruled in the Commissioner's favor, and specifically concluded that the royalties were, in fact, taxable income of the husband. In so holding, the Tax Court relied upon its own prior decision in *Estate of Dodson* v. *Commissioner*, 1 T. C. 416, which presents a comparable situation. There the owner of a formula and trade-mark made a contract with a corporation (in which he owned 51% of the stock and his wife owned the remainder), under which it was given exclusive use of the formula and trade-mark for five years, renewable for a like period, and was to pay in return a royalty measured by a certain percentage of the net sales. Thereafter he assigned a one-half interest in the contract to his wife, retaining his full interest in the formula and trade-mark, and the question arose whether he thereby shifted to his wife the responsibility for the taxes on the income in the form of royalties which were thereafter paid. In holding the as-

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signor and not his wife accountable for the income in question, the Tax Court referred to the following language of this Court in *Harrison* v. *Schaffner*, 312 U. S. 579, 583–584:

> * * * we leave it to future judicial decisions to determine precisely where the line shall be drawn between gifts of income-producing property and gifts of income from property of which the donor remains the owner, for all substantial and practical purposes. Cf. *Helvering* v. *Clifford, supra.*

And then the Tax Court said (1 T. C. at page 423):

> Assuming in petitioner's favor, without deciding, that the royalty contract, which provided for reimbursement to decedent for the use of the trade-mark, was income-producing property, separate and distinct from the trade-mark itself, nevertheless, we are of the opinion that under the peculiar facts of the instant case decedent remained "for all substantial and practical purposes" the owner of the royalty contract and that the sole purpose intended and accomplished by the assignment of a one-half interest therein to his wife was to give her one-half of the income therefrom. See *Helvering* v. *Eubank, supra.* The only two parties to the royalty contract were decedent and a corporation which he controlled. Even after he had assigned a one-half interest in the contract to his wife, he and his controlled corporation could have modified or abrogated the contract at any time by

> mutual consent (which, under the circumstances, was equivalent to unilateral action on his part). There is nothing in the record here to suggest that this power was limited by any rights of creditors of the controlled corporation. By reason of this power over the contract, we conclude that for all substantial and practical purposes he remained the owner of the contract, and that the only substantial and practical result of the assignment in question was a gift to his wife of the income derived from the contract so long as decedent wished the contract to exist unmodified.

We submit that the Tax Court's decision is correct and blends harmoniously with well-settled principles of tax law.

It has become firmly established that the mere assignment of income does not relieve the assignor from tax. *Lucas* v. *Earl*, 281 U. S. 111; *Burnet* v. *Leininger*, 285 U. S. 136; *Helvering* v. *Horst*, 311 U. S. 112; *Helvering* v. *Eubank*, 311 U. S. 122; *Harrison* v. *Schaffner*, 312 U. S. 579; *United States* v. *Joliet & Chicago R. Co.*, 315 U. S. 44; *Commissioner* v. *Harmon*, 323 U. S. 44. And although it is generally true that the owner of property is no longer liable for tax upon the income therefrom after he has disposed of the property itself, he may still be accountable for the income if he has retained substantial incidents of ownership in the underlying property, particu-

larly where the income is merely reallocated within the family group. *Helvering* v. *Clifford*, 309 U. S. 331; *Hormel* v. *Helvering*, 312 U. S. 552; *Helvering* v. *Fuller*, 310 U. S. 69, 72, 76; *Helvering* v. *Stuart*, 317 U. S. 154, 167; *Commissioner* v. *Tower*, 327 U. S. 280; *Lusthaus* v. *Commissioner*, 327 U. S. 293.[1]

Tested by these familiar principles, the conclusion of the Tax Court in the instant case that the taxpayer is accountable for the income in question seems clearly correct.

If the taxpayer had assigned the patent royalties alone, or the future income from the patents which he owned, it could hardly be seriously contended that he would not be taxable under the foregoing principles. For this Court has long recognized that "an assignment, where the assignor continued to own the corpus, does not immunize him from taxation upon the income" (*Reinecke* v. *Smith*, 289 U. S. 172, 177), and a mere assignment of royalties where the assignor continues to own the patents would not relieve him of tax. We submit that the result is no different merely because the taxpayer attempted to cast the trans-

[1] Compare the decisions of this Court holding, in a wide variety of situations, that substance rather than form is the controlling consideration. *Commissioner* v. *Court Holding Co.*, 324 U. S. 331, 334; *Gregory* v. *Helvering*, 293 U. S. 465, 469–470; *Griffiths* v. *Commissioner*, 308 U. S. 355, 357; *Higgins* v. *Smith*, 308 U. S. 473, 477–478; *Minnesota Tea Co.* v. *Helvering*, 302 U. S. 609, 613; *Corliss* v. *Bowers*, 281 U. S. 376, 378.

action in the form of an assignment of the royalty *agreements* with his controlled corporation.

In the first place, he did not part with the inventions or the patents themselves. These he retained absolutely for himself, and they were in reality the ultimate source of the royalties.

In the second place, the license and royalty agreements were terminable upon notice of six months or one year (R. 65).[2] And the taxpayer, as owner of the patents and as president and owner of 89% of the stock in the corporation, was in a position to cancel the agreements in their entirety. The agreements explicitly provided for cancellation by *either* party "without liability for damages or breach" (R. 65), upon giving the required notice. The Circuit Court of Appeals improperly assumed (R. 97) that the powers of control were not substantial, on the theory that an attempted exercise of the powers would necessarily amount to a fraud on the corporation or on the taxpayer's assignee, which would be enjoined or would inevitably be defeated by the other directors of the corporation. But the taxpayer

[2] In view of the cancellation clauses, it seems unnecessary to note that, with only one exception, the licenses and royalty agreements were to run for ten years, a period which is characterized "as a relatively short term" in the Treasury regulations which undertake to spell out the extent of the rule in *Helvering* v. *Clifford, supra;* see also *Helvering* v. *Fuller*, 310 U. S. 69, 72, 76. Regulations 111, Sec. 29.22 (a)–21 (as added by T. D. 5488, 1946–1 Cum. Bull. 19, and amended by T. D. 5567, 1947–14 Int. Rev. Bull. 2).

might have caused a cancellation of the old contracts and have substituted new ones with more favorable terms to the corporation; surely there would be no fraud on the corporation in such case. Moreover, apart from the fact that she was a gratuitous assignee, Mrs. Sunnen would have no standing to complain of cancellation since her contractual rights were subject to the corporation's right to cancel upon notice without incurring liability. The license contracts did not require the corporation to manufacture and sell any particular number of devices, and did not specify minimum royalties payable (R. 33–34, 36–37, 39–41, 43–44). Thus, they did not guarantee that the licensor or his assignee would receive a minimum, or indeed any, royalties from the licensee. Even if it is assumed, despite the apparently harmonious family relationship, that the taxpayer's wife as a director would vote contrary to his wishes, it may not be assumed that the other directors were not amenable to his will, particularly since the directors were elected annually by the stockholders (R. 31–32), and a recalcitrant director could thus be removed by the taxpayer, the controlling stockholder.

In the third place, the licenses given by Mr. Sunnen to the corporation were not exclusive (R. 65). As owner of the underlying patents, he would have been within his rights in granting licenses to other corporations (which might be wholly owned by himself) and the business that

would otherwise go to this corporation might thus be diverted to the new corporations. *Western Electric Co.* v. *Pacent Reproducer Corp.*, 42 F. 2d 116 (C. C. A. 2), certiorari denied, 282 U. S. 873; Amdur, *Patent Law and Practice* (1935), Chap. XII, Sec. 14, pp. 571–572; 2 Walker, *Patents* (Deller's ed., 1937), Sec. 366, pp. 1459, 1462.

Plainly, this case involves merely an anticipatory arrangement for reallocation of income within the family group, and is governed by such decisions as *Lucas* v. *Earl*, 281 U. S. 111; *Helvering* v. *Horst*, 311 U. S. 112; *Helvering* v. *Eubank*, 311 U. S. 122; *Harrison* v. *Schaffner*, 312 U. S. 579; *Helvering* v. *Clifford*, 309 U. S. 331; *Commissioner* v. *Tower*, 327 U. S. 280; and *Lusthaus* v. *Commissioner*, 327 U. S. 293. In no real sense can this case be regarded as involving a complete disposition of property so that the transferee rather than the transferor becomes accountable for tax on the income therefrom. And *Blair* v. *Commissioner*, 300 U. S. 5, relied upon by the taxpayer, has been explained by this Court as resting upon such basis. See *Harrison* v. *Schaffner*, 312 U. S. 579, 582.

In reversing the Tax Court, the court below erroneously focused upon the royalty contracts, treated them as the source of the income, and concluded that since the taxpayer had given the contracts away he could no longer be charged with tax upon the royalties themselves. But the court below was not warranted in thus isolating the

royalty agreements. They were part of a larger picture, in which the taxpayer continued to own the underlying inventions and patents and in which he retained most effective control over the royalty and license agreements. By exercising his legal rights, he could have diminished or curtailed entirely the income payable to his wife under the assignments, and the result would not in any sense have constituted any actionable fraud upon her.

Even in the absence of such sweeping controls as were in fact retained by the taxpayer, the court below would not have been justified in treating the royalty contracts as the crucial source of the income. It may be assumed that a royalty contract is property, just as a lease is property. Cf. *Hort* v. *Commissioner,* 313 U. S. 28, 31. But the inventions and the patents themselves constitute the property that is the underlying source of the royalty income. The royalty contracts are merely the media selected by the owner of the patents to regulate the flow of income. And it seems plain that a taxpayer who retains ownership of a patent cannot by the simple expedient of assigning the royalty contract thereby escape taxes on income that he would be required to pay had he merely assigned the future royalties.[3] Cases of this

[3] The court below made the broad statement that the "rule seems to be established that a royalty contract is the producing source of the royalty income and that such income is taxable to the assignee," citing seven cases as authority (R. 95). The only one of them which involved an assigned patent roy-

type are not to be decided upon the basis of such "attenuated subtleties." *Helvering* v. *Horst*, 311 U. S. 112, 120; *Lucas* v. *Earl*, 281 U. S. 111, 114.[4]

In the light of the foregoing considerations, we submit that the court below was clearly wrong in concluding that the taxpayer made a completed gift, without reservations and without retention of control, which would shift the incidence of the

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alty contract is *Nelson* v. *Ferguson*, 56 F. 2d 121 (C. C. A. 3), certiorari denied, 286 U. S. 565, a decision which seems unsound in the light of subsequent decisions of this Court. The taxpayer in *Helvering* v. *Eubank*, 311 U. S. 122, unsuccessfully placed heavy reliance upon it. In any event, however, the inventor in the *Nelson* case assigned the patent itself to a corporation in which he was apparently only an employee, in circumstances quite unlike those present here.

[4] Similarly in the case of assignment of rents from real estate, we think that the owner of the real estate remains liable for tax upon the rents, whether the transaction takes the form of a mere assignment of the rents, or of an assignment of the lease, particularly where the lease is for a short term. The distinction adopted in *Lum* v. *Commissioner*, 147 F. 2d 356 (C. C. A. 3) between the two types of assignments is, we submit, unsound.

The illustration given in *Helvering* v. *Horst*, 311 U. S. at 119 with respect to rents from a leasehold, refers, we think, merely to an assignment of his entire interest by the owner of only a leasehold. Certainly, the Court was not considering the situation whereby an owner of property was attempting to deflect the rents through the device of assigning the lease, while at the same time retaining the real estate itself. Indeed, the tenor of the opinion as a whole would forbid the conclusion that a distinction is to be drawn between the assignment of rents for a specified period, on the one hand, and an assignment of the lease for the same period, on the other hand, so long as the assignor continues to own the property that produces the income.

tax. Accordingly, it is unnecessary to determine whether its appellate review was restricted by *Dobson* v. *Commissioner*, 320 U. S. 489. In a sense, the case involves a legal principle of general application, based upon a number of judicial decisions, to the effect that the owner of property (in this case, patents) may not avoid tax by deflecting the income therefrom "by anticipatory arrangements and contracts however skilfully devised" (*Lucas* v. *Earl*, 281 U. S. at 115). But that is a generalizing principle which has already been established by the decisions of this Court. And since that principle was correctly recognized by the Tax Court, it would seem that its application to the facts of this case should have been left undisturbed by the court below.

II

THE DOCTRINE OF RES JUDICATA IS INAPPLICABLE HERE

In the Tax Court the taxpayer contended that an earlier decision of the Board of Tax Appeals (rendered in 1935) relating to royalties paid in the years 1929–1931, favorable to him, was conclusive of the present controversy under the doctrine of *res judicata*. The present case involves the years 1937–1941, and of the total of over $260,000 in royalties paid during this period (R. 68), only $4,881.35 was paid (in 1937) under the contract that was involved in the prior proceeding. The remaining royalties were paid

under entirely separate, although similar, contracts, and the great bulk thereof related to wholly different patents that were not in any way involved in the earlier case.

The Tax Court held that the doctrine of *res judicata* did not apply, except as to the $4,881.35 in royalties paid in 1937 under the original contract. Both the taxpayer and the Commissioner appealed. The court below affirmed the Tax Court on the Commissioner's appeal (R. 99–100), but found it unnecessary to consider the issue of *res judicata* on the taxpayer's appeal, since it had concluded that he was not taxable in any event (R. 100–101). We do not here bring into controversy the propriety of the action of the court below on the Commissioner's appeal; however, since the taxpayer, as respondent, may renew his contention as to *res judicata* in order to seek to support the judgment in his favor on that ground, we shall state briefly our views on this issue.[5]

[5] The Government preserved the point as to the $4,881.35 payment in its specification of errors in the petition for certiorari (p. 11), but made it clear that it was not one of the grounds for granting certiorari. In the circumstances, it seems desirable not to press that minor point here since it might tend to becloud the issue on the merits which was the only reason for seeking certiorari. We shall discuss the taxpayer's *res judicata* point only because he, as a respondent, is entitled to raise it; but even as to that point, this Court may prefer, in its discretion, not to consider the matter, and leave it for further consideration by the court below, which has not yet passed upon it. Cf. *Commissioner* v. *Munter*, 331 U. S. 210, 216–217; *United States* v. *Ballard*, 322 U. S. 78, 88.

The earlier proceeding before the Board of Tax Appeals dealt with Mr. Sunnen's tax liability for the years 1929–1931. The Commissioner in no way seeks to disturb the judgment entered for those years. There was originally considerable doubt whether the doctrine of *res judicata* could apply in federal tax situations other than attempts to relitigate the identical tax liability disposed of in the prior litigation, particularly since no such concept is spelled out in the revenue laws. But, this Court held in *Tait* v. *Western Md. Ry. Co.*, 289 U. S. 620, that the doctrine applies as to taxes for different years,[6] where the liability is based upon an identical factual situation. (In the *Tait* case, the issue on the merits involved the deductibility of amortized bond discount with respect to the identical bond issues which had been the subject of prior litigation.) However, it is clear that the rule of the *Tait* case is subject to strict limitations (cf. *Blair* v. *Commissioner*, 300 U. S. 5, 8–9), and there are at least several reasons why it is inapplicable here.

1. The principle of *res judicata* does not apply

[6] The Court has refused similarly to extend the doctrine of *res judicata* in cases involving the customs laws (*United States* v. *Stone & Downer Co.*, 274 U. S. 225), although that result seems to have been explained in the *Tait* opinion chiefly on historical grounds. See 289 U. S. at 625. And, in other instances, the Court has shown considerable reluctance to extend the concept of *res judicata*. Cf. *Federal Trade Commission* v. *Raladam Co.*, 316 U. S. 149; *United Shoe Mach. Co.* v. *United States*, 258 U. S. 451.

in this case because the facts and issues here are not identical with the facts and issues in the earlier case. This is not a case where, as in the *Tait* case, 289 U. S. 620, 626, "all the facts" in the later case were before the adjudicating body in the prior case. Where the question in issue, in suits covering different periods of time, is dependent upon facts existing in the two respective periods, it has been frequently held that judgment entered in one suit is not conclusive in a second suit, even though the proof shows that the relevant facts are "similar" or "substantially the same." *Engineer's Club of Phila.* v. *United States,* 42 F. Supp. 182, 187 (C. Cls.), certiorari denied, 316 U. S. 700, rehearing denied, 317 U. S. 705; *Snyder* v. *Commissioner,* 73 F. 2d 5, 6 (C. C. A. 3), affirmed on grounds other than *res judicata,* 295 U. S. 134; *Henricksen* v. *Seward,* 135 F. 2d 986 (C. C. A. 9); *Stoddard* v. *Commissioner,* 141 F. 2d 76, 79–80 (C. C. A. 2); *Monteith Bros. Co.* v. *United States,* 142 F. 2d 139 (C. C. A. 7); *Commissioner* v. *Netcher,* 143 F. 2d 484 (C. C. A. 7), certiorari denied, 323 U. S. 759; *Corrigan* v. *Commissioner,* 155 F. 2d 164 (C. C. A. 6); *Duquesne Club* v. *Bell,* 42 F. Supp. 123 (W. D. Pa.), reversed on other grounds, 127 F. 2d 363 (C. C. A. 3), certiorari denied, 317 U. S. 638, rehearing denied, 317 U. S. 706; *Campana Corp.* v. *Harrison,* 135 F. 2d 334 (C. C. A. 7); *Linen Thread Co., Ltd.* v. *Commissioner,* 4 T. C. 802, affirmed, 152

F. 2d 625 (C. C. A. 2); cf. *Argo* v. *Commissioner*, 150 F. 2d 67 (C. C. A. 5), certiorari denied, 326 U. S. 762; *Travelers Ins. Co.* v. *Commissioner*, 161 F. 2d 93 (C. C. A. 2), certiorari denied October 13, 1947, No. 208, present Term. These cases disclose a sound effort to apply the doctrine of *res judicata* in situations involving different tax periods only where the issues are "identical." See Griswold, *Res Judicata in Federal Tax Cases* (1937), 46 Yale L. J. 1320, 1357.

Here, as in the *Engineer's Club* case, *supra*, the facts in the two periods may have been "similar," but "they were a completely different set of events, and they were not the set of events litigated in the earlier cases." 42 F. Supp. 182, 187. Although the ultimate question in both the present case and the prior proceeding relates to taxability of income from royalty contracts assigned to the taxpayer's wife, *none* of the royalty contracts and assignments now before the Court were involved in the earlier case. Moreover, all of the contracts except one (the cylinder grinder contract of 1938) were concerned with patents that were not in issue in the earlier case. Indeed, the two crankshaft grinder patents were not even applied for until 1939 (R. 64). In the circumstances, it seems plain that there is no adequate basis for the application of *res judicata*.

2. A second reason why *res judicata* is inapplicable here is that since the decision of the Board

was promulgated in 1935 in the earlier case, decisions of this Court have been rendered in such important cases as *Helvering* v. *Clifford*, 309 U. S. 331; *Helvering* v. *Horst*, 311 U. S. 112; *Helvering* v. *Eubank*, 311 U. S. 122; *Harrison* v. *Shaffner*, 312 U. S. 579; *Commissioner* v. *Tower*, 327 U. S. 280; and *Lusthaus* v. *Commissioner*, 327 U. S. 293. Since the doctrine of *res judicata* is one that forecloses inquiry into the correct disposition of a case on the merits, it should have no application in tax controversies involving different periods where there are intervening decisions that make clear the error of the earlier decision. In *Blair* v. *Commissioner*, 300 U. S. 5, this Court refused to apply the *Tait* case where there had been an intervening decision of a state court with respect to the character of a particular trust that was the subject matter of both the earlier and subsequent tax proceedings. And since the *Blair* case, the courts have often recognized the principle that *res judicata* does not preclude the correct decision of a tax question for a particular year, if there has arisen since a previous decision a "new situation" created by authoritative intervening decisions with respect to controlling legal principles. See *Corrigan* v. *Commissioner*, 155 F. 2d 164, 165 (C. C. A. 6); *Commissioner* v. *Arundel-Brooks Concrete Corp.*, 152 F. 2d 225, 226–227 (C. C. A. 4); *Commissioner* v. *Security-First Nat. Bank*, 148 F. 2d 937, 940–941 (C. C.

A. 9); *Blaffer* v. *Commissioner*, 134 F. 2d 389, 390 (C. C. A. 5); *Henricksen* v. *Seward*, 135 F. 2d 986 (C. C. A. 9); cf. *Pelham Hall Co.* v. *Hassett*, 147 F. 2d 63, 68–69 (C. C. A. 1); *Gillespie* v. *Commissioner*, 151 F. 2d 903, 906 (C. C. A. 10); *State Farm Ins. Co.* v. *Duel*, 324 U. S. 154, 162; but cf. *Commissioner* v. *Western Union Tel. Co.*, 141 F. 2d 774 (C. C. A. 2), certiorari denied, 322 U. S. 751.

We respectfully submit that although the correct disposition of controversies such as this on the merits should have been foreshadowed by *Lucas* v. *Earl*, 281 U. S. 111, nevertheless the extensive development of the subject through such cases as the *Clifford, Horst, Eubank, Shaffner, Tower,* and *Lusthaus* cases has created a new and different situation. The doctrine of *res judicata* should not apply in a case of this kind where the earlier decision was rendered more than ten years ago, particularly since there is no statutory provision whatever that precludes the correct disposition of a tax controversy for a given year, merely because of a prior erroneous decision involving a different liability for an earlier year. That the prior decision herein in 1935 was erroneous is now amply recognized by the Tax Court itself in this very case. The doctrine of *res judicata* should have no application here.

CONCLUSION

The decision of the Circuit Court of Appeals is unsound. It should therefore be reversed and the decision of the Tax Court reinstated.

Respectfully submitted.

PHILIP B. PERLMAN,
Solicitor General.
THERON LAMAR CAUDLE,
Assistant Attorney General.
ARNOLD RAUM,
HELEN R. CARLOSS,
L. W. POST,
Special Assistants to the Attorney General.

NOVEMBER, 1947.

APPENDIX

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—*"Gross income"* includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever * * * (26 U. S. C. 1940 ed., Sec. 22).

SEC. 1141. COURTS OF REVIEW.

(a) *Jurisdiction.*—The Circuit Courts of Appeals and the United States Court of Appeals for the District of Columbia shall have exclusive jurisdiction to review the decisions of the Board,[1] except as provided in section 239 of the Judicial Code, as amended, 43 Stat. 938 (U. S. C., Title 28, § 346); and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the man-

[1] The name of the Board of Tax Appeals was changed to that of The Tax Court of the United States by Section 504 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798 (26 U. S. C. 1940 ed., Supp. V, Sec. 1100).

ner provided in section 240 of the Judicial Code, as amended, 43 Stat. 938 (U. S. C., Title 28, § 347).

* * * * * *

(c) *Powers.*—

(1) *To affirm, modify, or reverse.*—Upon such review, such courts shall have power to affirm, or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require.

(26 U. S. C. 1940 ed., Sec. 1141).

(Section 22 (a) of the Revenue Acts of 1938, c. 289, 52 Stat. 447, and of 1936, c. 690, 49 Stat. 1648, is the same as Section 22 (a) of the Internal Revenue Code.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.22 (a)–1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. Profits of citizens, residents, or domestic corporations derived from sales in foreign commerce must be included in their gross income; but special provisions are made for nonresident aliens and for for-

eign corporations by sections 211 to 238, inclusive, and, in certain cases, by section 251, for citizens and domestic corporations deriving income from sources within possessions of the United States. Income may be in the form of cash or property.

* * * * *

Article 22 (a)–1 of Treasury Regulations 101, promulgated under the Revenue Act of 1938, and Article 22 (a)–1 of Treasury Regulations 94, promulgated under the Revenue Act of 1936, are the same.

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CHARLES ELMORE CROPLEY

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1947.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,
vs.
JOSEPH SUNNEN,
Respondent.
No. 227.

BRIEF

Of Respondent in Opposition to Petition for Writ of Certiorari.

C. P. FORDYCE,
506 Olive Street,
St. Louis 1, Missouri,
Counsel for Respondent.

ST. LOUIS LAW PRINTING CO., 415 North Eighth Street. CEntral 4477.

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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1947.

COMMISSIONER OF INTERNAL REVENUE, *Petitioner,* vs. JOSEPH SUNNEN, *Respondent.*	}	No. 227.

BRIEF

Of Respondent in Opposition to Petition for Writ of Certiorari.

I.

STATEMENT OF CASE.

Petitioner's statement contains no reference to the following facts which we deem pertinent:

The manufacture and sale by Sunnen Products Company of the patented cylinder grinder, pin-hole grinder, and two

crank shaft grinders, pursuant to the royalty-license agreements executed by it and Mr. Sunnen, constituted more than half of the business of that company (R. 32).

The company employed from 90 to 220 persons, and paid them wages varying from approximately $189,000.00 per year to approximately $372,000.00 per year (R. 32).

The company owed its creditors amounts varying from approximately $123,000.00 to $574,000.00 (R. 32).

Mrs. Sunnen possessed a large independent fortune (R. 52).

The various assignments executed by Mr. Sunnen and delivered to his wife show clearly that in each case he assigned to her all of his right, title, and interest in and to the royalty-license agreements, and not merely his right to future royalties (R. 35-36, 38-39, 42, 45-46).

The decision of the Board of Tax Appeals in Mr. Sunnen's prior case, holding him not liable for 1929, 1930 and 1931 income taxes on cylinder grinder royalties paid to his wife, was based upon the finding that the royalty contract was an assignable property right, that the assignment vested the title to the income-producing property in Mrs. Sunnen, and that the royalty-license contract and not Mr. Sunnen produced the royalty income (R. 59-60).

II.

QUESTION PRESENTED.

On page 2 of the petitioner's brief he states his version of the question presented by this case. In his statement he refers to the royalty-license contracts as having been executed by Mr. Sunnen and his "controlled corporation."

We submit that the word "controlled" is unfair, and tends to prejudice this Court against the respondent. This claim of "control" is based on the fact that Mr. Sunnen owned 1,780 out of the 2,000 shares issued by the corporation (R. 26). However, ownership of a majority of stock in a corporation does not give the holder unqualified and absolute control over the corporation, especially where as here the stipulated facts show that a vote of three of the five directors of the company was required in order to take any action binding upon it (R. 32).

It is our opinion, therefore, that the question presented should be stated as follows: Whether a majority stockholder of a corporation, who owns patent applications and patents, who then enters into royalty-license contracts with the corporation for the manufacture and sale of the inventions, who subsequently assigns all of his right, title, and interest in and to such contracts to a minority stockholder of the corporation, and who thereafter notifies the corporation of such assignments, is taxable upon the royalties later paid by the corporation to the assignee.

This question is presented on the peculiar facts of this case. In our opinion, this Court will never again be called upon to pass upon similar facts.

III.

STATUTES AND REGULATIONS INVOLVED.

Petitioner contends that this case involves Sec. 22 (a) of the Internal Revenue Code (26 U. S. C., 1940 ed., S. 22); Sec. 22 (a) of the Revenue Act of 1938 (c. 289, 52 Stat. 447); Sec. 22 (a) of the Revenue Act of 1936 (c. 690, 49 Stat. 1648); Sec. 19.22 (a)-1 of Treasury Regulation 103; Art. 22 (a)-1 of Treasury Regulation 101, promulgated under the Revenue Act of 1938; and Art. 22 (a)-1 of Treasury Regulation 94, promulgated under the Revenue Act of 1936. (See pages 2-4 of petitioner's brief.)

We contend that the above mentioned sections of the Law and Regulations have no application to the case at bar. They merely define what constitutes taxable income. They say nothing about whether one person or another is taxable upon income as so defined. They contain not one word justifying the taxation of the royalties here involved to the respondent.

IV.

SUMMARY OF ARGUMENT.

FIRST.

A: The petitioner contends that the Circuit Court of Appeals' decision violates decisions of this Court holding that one who assigns the right to receive income, but retains ownership of the property producing that income, is, despite the assignment, taxable upon the income paid to the assignee. This contention is predicated on the argument that the royalty income paid to Mrs. Sunnen was produced, not by the royalty contracts assigned to her by respondent (her husband), but by the patents which he continued to own. The petitioner cites no cases of this Court, or any other Court, in support of such argument. The same argument was rejected by the Board of Tax Appeals in a prior case involving Mr. Sunnen. In the case at bar, the Tax Court refused to approve this argument, and the Circuit Court of Appeals flatly denied it. Numerous cases cited by us show that the income here involved was produced by the assigned royalty contracts. Especially analogous are cases involving leases assigned by a landowner, wherein it is held that the assignee is taxable upon the rent, despite the continued ownership of the land by the assignor. The patents and royalty contracts, as well as the land and leases, involve severable and distinct property rights, which should not be confused. The contrary view leads to absurd tax results.

B: In the alternative the petitioner argues that the Circuit Court of Appeals' decision violates decisions of this Court holding that even though one assigns income-producing property, he is taxable on the income produced thereby if he retains incidents of control sufficient to support the conclusion that he remains in substance the true owner of

the assigned property. Petitioner thus contends that the *Clifford* Doctrine should be applied to this case. He makes this claim despite the fact that a lawfully organized and operated business corporation, such as is here involved, is not the equivalent of a short-term family trust. He makes this claim despite the fact that Mr. Sunnen's rights (as patent owner and as majority stockholder of Sunnen Products Company), were insignificant; and the rights acquired by Mrs. Sunnen under the assignments—including the full right to sell the assigned contracts—exactly coincides with the normal conceptions of full ownership. Mrs. Sunnen's rights (as assignee of the royalty contracts and as minority stockholder of Sunnen Products Company) could not be defeated by any legal act of her husband. Self-interest of Mr. Sunnen, as majority stockholder, would have prevented him from illegally attempting to force the company to cancel the royalty contracts, or otherwise attempting to sabotage its business. In essence, the petitioner's argument seeks to predicate tax liability on power to misappropriate money of another. No Court should base a decision upon conjecture or possible fraud. This Court recently refused to do so in the *Wilcox* case involving embezzled money. Moreover, to base a finding of substantial ownership, upon the power of a majority stockholder over his corporation, violates the decision of this Court holding that even the power of a sole stockholder over a corporation does not justify taxing him upon the corporation's income. The petitioner's argument, therefore, obviously proves too much. It overlooks the fact that Mr. Sunnen could derive no economic gain from exercising any power possessed by him. It overlooks the fact that he had no lawful claim to these royalties. It ignores the substantial adverse interests posessed by Mrs. Sunnen. Any power possessed by Mr. Sunnen was conditioned on acts which he might not be able to perform, and was not the equivalent of "unfettered command." To tax Mr. Sunnen, or any taxpayer, upon in-

come which he cannot use to pay such taxes, seriously jeopardizes the Government's ability to collect its taxes—a matter just as important as proper assessment of taxes.

C: The petitioner contends that the Circuit Court of Appeals' decision violates decisions of this Court holding that earned income is taxable to the person who earned it. This contention is inconsistent with petitioner's argument that the patents produced the royalty income. Moreover, such contention is absurd. The royalties here involved were earned by the use of capital of Sunnen Products Company, and the labor of its employees, not by any personal services rendered by Mr. Sunnen.

SECOND.

As an afterthought, the petitioner contends that the judgment of the Circuit Court of Appeals violates decisions of this Court prescribing the scope of Appellate review of decisions of the Tax Court. The Circuit Court of Appeals was mindful of these decisions. Nevertheless, it held that if the Tax Court's finding be one of fact it was without warrant in the record, and if it be a conclusion of law it was without any reasonable basis in the law. In addition, we say that if the Tax Court's finding in the case at bar be considered one of fact, it cannot be decisive because it directly conflicts with that Court's own finding in Mr. Sunnen's prior case. However, we contend that the Tax Court's finding was one of law. It was based upon erroneous application of the law regarding corporate stockholders and assignments, and thus constituted an error of law. The Tax Court's ultimate finding of substantial ownership of income-producing property by Mr. Sunnen, involved the legal effect of admitted facts, and presented a pure question of law. The Tax Court's finding involved the construction and effect, under Missouri law, of various written instruments, which is a question of law. The Tax

Court's finding involved the power of misappropriation as an element of substantial ownership under the *Clifford* Doctrine, which this Court held in the *Wilcox* case to be a question of law. The Tax Court's finding involved an erroneous extension and misapplication of the decision of this Court in the *Clifford* case—a question of law. No cases cited by the petitioner disprove these statements.

THIRD.

This case involves no new question of law requiring consideration by this Court. Basically it involves only the question of whether the owner of income-producing property is taxable upon the income produced thereby. The petitioner's argument that the Circuit Court of Appeals' decision will cause a tax saving crusade, is belied by his failure to seek review of Mr. Sunnen's prior case, which was decided by the Board of Tax Appeals in 1935.

V.

ARGUMENT.

FIRST: The Decision of the Circuit Court of Appeals Does Not Conflict With Any Decision of This Court.

A. *Assignment of Income or Income-Producing Property.*

Petitioner first contends that the decision of the Circuit Court of Appeals conflicts with the decisions of this Court, cited on page 11 of his brief, holding that one who assigns the right to receive income, but retains ownership of the property producing that income, is, despite the assignment, taxable upon the income paid to the assignee.

This rule is clearly not applicable unless it can be said, as petitioner argues, that the royalty income paid to Mrs. Sunnen was produced by the patents and patent applications which Mr. Sunnen continued to own, and not by the royalty agreements which he assigned to her. *To support this argument, the petitioner cites no cases of this Court, or any other Court.*

This argument was rejected by the Board of Tax Appeals in Mr. Sunnen's prior case (R. 59-60). The Board cited many authorities,[1] including the closely analogous case of *Edward G. Swartz, Inc., v. Commissioner*, 5 Cir., 69 Fed. 2d 633, 635. In that case Mr. Swartz, who owned timber land, entered into a timber cutting contract with Bernard Cypress Company, providing for the payment to him of part of the profits derived from the cutting and sale of the timber. Subsequently, Mr. Swartz assigned all of his right, title, and interest in and to this contract to

[1] *Nelson v. Ferguson*, 3 Cir., 56 Fed. 2d 121, 124, cert. den. 286 U. S. 565 (wherein the assignee of the royalty contract had no interest whatever in the patent); *Leydig v. Commissioner*, 15 B. T. A. 124, affd. 10 Cir., 43 Fed. 2d 494; *Field v. Commissioner*, 2 Cir., 42 Fed. 2d 820, 822; *Copland v. Commissioner*, 7 Cir., 41 Fed. 2d 501, 504; *Smith et al., Extrs., v. Commissioner*, 25 B. T. A. 291; *Lowery v. Helvering*, 2 Cir., 70 Fed. 2d 713, 714.

Edward G. Swartz, Inc., in exchange for all of its stock except two qualifying shares. Swartz, however, individually retained ownership of the lands. In answer to the contention of the corporation that all income paid by the Cypress Company was taxable to Mr. Swartz individually, the Court on page 635 said:

> "Here the creator (Swartz) has assigned to the creature (Edward G. Swartz, Inc.) the thing itself from which the income flows. Before the assignment Swartz was the owner of the income because he owned the contract which yielded it. After the assignment the company owned the income, for after it the contract was not Swartz's but its own. The petitioner's claim that it was not the owner of the income because Swartz had not assigned to it the timber but only the contract, is without merit. The actual, the present interest in the timber, the right to have it cut and marketed, and the right to the proceeds from that cutting and marketing, Swartz, by assigning the right and title to the contract, assigned to petitioner. Unless and until there was a breach sufficient to authorize cancellation of the contract, the right Swartz had in the timber was the right to insist that it be cut as the contract provided, and that he receive for it the price the contract fixed. These rights he fully assigned to petitioner. The ownership of these rights involved, it drew to itself all that proceeded from the contract. The owner of these rights was the owner of the income they produced. Nothing in the *Earl Case* (281 U. S. 111, 74 L. Ed. 731), or in those which have followed it, makes these payments taxable to Swartz. To tax Swartz and not petitioner would, we think, be to impose a tax on one on account of the income of another." (Citing *Poe v. Seaborn*, 282 U. S. 101, 51 S. Ct. 58, 75 L. Ed. 239; *Hoeper v. Tax Commission*, 284 U. S. 206, 52 S. Ct. 120, 76 L. Ed. 248, and other cases.)

Even the Tax Court, in the case at bar, did not repudiate the principle that a contract right to a certain percentage

of the royalties on an invention is itself income-producing property and the holder of such right is taxable on the royalties paid thereunder. This is clearly shown by *Strauss v. Commissioner*, 8 T. C. No. 121, CCH Decision No. 15,787, decided May 15, 1947. In that case the Tax Court held that a husband, who helped finance the development and patenting by others of a process for making colored film known as Kodachrome, who for such financial assistance acquired a right to receive a certain percentage of royalties on and an interest in the process, and who later, as a gift, assigned to his wife (who had no interest whatever in the patents) all of his "right, title, and interest in Kodachrome," was not taxable on royalties subsequently paid to his wife. *Sunnen v. Commissioner*, 6 T. C. 431, was distinguished solely because of the alleged control possessed by Mr. Sunnen over Sunnen Products Company.

The petitioner's argument that the patent and patent applications produced the royalties paid to Mrs. Sunnen was also flatly rejected by the Circuit Court of Appeals in the case at bar (R. 95, 96).[2]

Moreover, the petitioner's argument conflicts with the fundamental principles enunciated in the following cases, which have never been repudiated by this Court: *Lilienfeld v. Commissioner*, 35 B. T. A. 391, 395 (acquiesced in by Commissioner, 1937—1 C. B. 15), (involving royalty contracts assigned to wife who had no interest in patent); *Timken, Est. of H. H. v. Commissioner*, 47 B. T. A. 494, affd. 6 Cir., 141 Fed. 2d 625 (note with past due interest assigned); *Ray, Rose L. v. Commissioner*, P-H, B. T. A. Memo. Decision Par. 41,325, CCH Decision No. 11,874A (oil

2. The Circuit Court of Appeals cited *Commissioner v. Field*, supra; *Lowery v. Helvering*, supra; *Hall v. Burnett*, App. D. C., 54 Fed. 2d 443, 446, cert. den. 285 U. S. 552; *Nelson v. Ferguson*, supra; *Helvering v. Seatree*, App. D. C., 72 Fed. 2d 67, 68; *Shanley v. Bowers*, 2 Cir., 81 Fed. 2d 13, 15; *Commissioner v. O'Donnell*, 9 Cir., 90 Fed. 2d 907, 910, revd. on other grounds, 303 U. S. 370; *Commissioner v. Ross*, 6 Cir., 83 Fed. 2d 18, 19, 20; *Lum v. Commissioner*, 3 Cir., 147 Fed. 2d 356, 357; and *Blair v. Commissioner*, 300 U. S. 5, 13.

and gas leases assigned); *Commissioner v. Montgomery*, 5 Cir., 144 Fed. 2d 313, 316 (construction contract assigned to family corporation by majority stockholder); *Fox v. Commissioner*, 37 B. T. A. 271, 278 (royalty contract assigned to corporation by sole stockholder); *Montgomery v. Thomas*, 5 Cir., 146 Fed. 2d 76, 80 (stock in family corporation purchased for children by majority stockholder); *Ross, Est. of W. L. v. Commissioner*, T. C. Memo. Opinion, 2 T. C. M. 573, 575, CCH Decision No. 13,416M (contract assigned); *Allen v. First National Bank and Trust Company*, 5 Cir., 157 Fed. 2d 592 (life interest in trust corpus assigned), cert. den. on March 3, 1947, 91 L. Ed. 691; *Porter Royalty Pool, Inc., v. Commissioner*, 7 T. C. 685, 696-697, CCH Decision No. 15,362 (interest in oil leases assigned to corporation by landowner); *Funk, W. J., v. Commissioner*, T. C. Memo. Opinion, 3 T. C. M. 100, CCH Decision No. 13,727M, 1947, P-H, T. C. Memo. Decision Par. 44,030, and *Funk, E. M., v. Commissioner*, 7 T. C. 890, CCH Decision No. 15,397 (both involving stock in family corporation assigned by President and majority stockholder); and *Wheelock v. Commissioner*, 7 T. C. 98, CCH Decision No. 15,216 (stock in family corporation assigned by President and majority stockholder). Compare also *Friedman v. Commissioner*, 45 B. T. A. 976, 983, affd., 4 Cir., 130 Fed. 2d 305 (involving assigned attorney-client contract).

In addition, we desire to point out that to adopt the petitioner's argument—to hold that the patents were the income-producing property—would lead to such absurd tax results as taxing a person who might buy the patents from Mr. Sunnen on royalties paid after such purchase to Mrs. Sunnen; and taxing Mr. Sunnen, if he retained the patents, on royalties paid to one who might buy the royalty contracts from Mrs. Sunnen. The property rights involved in the patents and contracts were separate and distinct.

Clearly these royalties were produced by the royalty contracts. Without them Mr. Sunnen's patents and patent applications would not have been exploited. No labor or capital would have been used to make and sell these grinding machines, and no royalties would have been paid to anyone. Unexploited patents never produce income. The actual and present interest in the patents, the right to have the patented devices manufactured and sold, and the right to a part of the proceeds of that manufacture and sale, Mr. Sunnen, by assigning all of his interest in the royalty contracts, assigned to Mrs. Sunnen. These views, which are in accord with principles long since firmly established by this Court, were adopted by the Circuit Court of Appeals in the case at bar. In its opinion the Circuit Court of Appeals said:

> "Unlike the transactions involved in *Helvering v. Horst,* supra; *Harrison v. Schaffner,* supra, and other cases cited supra, here the assignments of the royalty contracts were conveyances *in praesenti* of vested income-producing property rights. They were not mere gifts of money payable in the future from the earnings of the donor or from income-producing property owned by him. A royalty contract resembles a lease of real property and the royalties payable thereunder are analogous to rent. Had the royalty contracts not been assigned in the present case the royalties when paid to Sunnen would have been income taxable to him, the same as rents are taxable to the landlord. *Burnet v. Harmel,* 287 U. S. 103, 108. After the assignments the royalties were 'no more the income of the donor than would be the rent from a lease or a crop raised on a farm after the leasehold or the farm had been given away.' *Helvering v. Horst,* supra, 311 U. S. at page 119" (R. 96).

Nevertheless, on page 16 of his brief, the petitioner seeks to void the clear language used by this Court in the *Horst* case, supra. He argues that for a landowner to be relieved

from income taxes on rent paid under a lease assigned by him, the landowner must also assign his entire interest—the land as well as the lease. This argument is directly contrary to *Lum v. Commissioner,* supra; *Edward G. Swartz, Inc., v. Commissioner,* supra; and *Porter Royalty Pool, Inc., v. Commissioner,* supra. Compare also *J. S. Abercrombie Co. v. Commissioner,* 7 T. C. 120, affd. by the Circuit Court of Appeals of the Fifth Circuit on June 25, 1947, ... Fed. 2d ..., 1947 CCH Standard Federal Tax Reporter, Vol. 4, Par. 9301, holding that assignees were taxable for income accruing to their interests under assigned oil and gas leases, despite reservations of capital investment in minerals by assignors.

Ward v. Commissioner, 9 Cir., 58 Fed. 2d 757, 760, cited by petitioner on page 16 of his brief, is distinguishable because there the taxpayer assigned rentals only and not the income-producing leases. This case does not conflict with *Lum v. Commissioner,* supra, or with the other cases cited above.

We contend, therefore, that as Mr. Sunnen retained no income-producing property—that as he parted with the corpus—the decision of the Circuit Court of Appeals in the case at bar does not conflict with the decisions of this Court cited on page 11 of the petitioner's brief.[3]

B. *Substantial Ownership of Property—The Clifford Doctrine.*

The petitioner next argues that the decision of the Circuit Court of Appeals violates this Court's decision in *Helvering v. Clifford,* 309 U. S. 331, because, even though Mr. Sunnen may have made a legally perfect gift of income-

3 In making this contention we are giving to *Helvering v. Horst,* 311 U. S. 112; *Helvering v. Eubank,* 311 U. S. 122, and *Harrison v. Schaffner,* 312 U. S. 579, the meaning ascribed thereto by this Court in *Pearce v. Commissioner,* 315 U. S. 543, 554.

producing property, he retained incidents of control sufficient to support the conclusion that he was in substance the true owner of the property. The petitioner makes this contention despite the fact that no trust is involved in the case at bar and the Circuit Court of Appeals of the Fifth Circuit in *Commissioner v. Montgomery*, 144 Fed. 2d 313, 316, said: "*A lawfully organized and operated business corporation is not the equivalent of a trust.*" Furthermore, the petitioner alleges that the *Clifford* Doctrine is applicable even though Judge Magruder in *U. S. v. Morss*, 1 Cir., 159 Fed. 2d 142, 143, 146, pointed out that such doctrine applies only where the retained property rights coincide substantially "with the normal concepts of full ownership," and where the rights given away are "insignificant."

We contend that the *Clifford* Doctrine cannot be enlarged and extended to cover this case. This is apparent when we weigh both the property rights given to Mrs. Sunnen, and the property rights, if any, retained by Mr. Sunnen.

When the assignments were delivered to Mrs. Sunnen, and Sunnen Products Company received notice thereof, she acquired the following rights: the right to sell, assign, give away, pledge, or otherwise dispose of the royalty contracts—*rights which Mrs. Clifford did not possess* (309 U. S. at page 333)—; the right to cancel the royalty contracts in accordance with their terms; the right, with the consent of Sunnen Products Company, to alter or amend the royalty contracts so as to provide for greater or lesser royalties, payment of minimum royalties, etc.; the right to sue to enforce performance in good faith by Sunnen Products Company of such contracts; and the right to sue for damages for the breach thereof. In addition, Mrs. Sunnen, as bona fide assignee, had the right to claim the protection of the Courts of law and equity against any unauthorized, collusive, or arbitrary action by Mr. Sunnen, as assignor or as majority stockholder of Sunnen Products

Company, tending to interfere with, or defeat her rights. 4 *Am. Jur., "Assignments,"* Sec. 105, p. 312; 6 *C. J. S.*, s. 96, p. 1152, s. 101, p. 1158. Even the Commissioner's own Regulation[4] provides that where a transferee of property has such power over the property transferred, the *Clifford* Doctrine imposes ownership, and tax liability, on such transferee. See also *Richardson v. Commissioner*, 2 Cir., 121 Fed. 2d 1, 3, cert. den. 314 U. S. 684; *Jergens v. Commissioner*, 5 Cir., 136 Fed. 2d 497, 498; *Emery v. Commissioner*, 1 Cir., 156 Fed. 2d 728, 730; and *Conant v. Commissioner*, 7 T. C. 453, 461, all holding that transferees having analogous, or even lesser powers, to deal with corpus of the property transferred are to be deemed the substantial owners of such property.[5] It is clear, therefore, that the rights and powers given to Mrs. Sunnen, as assignee, are anything but "insignificant."

And in addition to these rights possessed by Mrs. Sunnen, as assignee, she possessed all rights incident to her ownership of 200 shares of stock of Sunnen Products Company (R. 26). Such rights gave her the power to prevent Mr. Sunnen, as majority stockholder of the company, from taking any steps to force the company to cancel the royalty contracts, and thus lose over one-half of its profitable business (R. 32). Regarding the duty of majority stockholders to use their power fairly and for the best interests of the corporation and its minority stockholders, see 13 *Fletcher, "Cyclopedia of the Law of Private Corporations,"* pages 137, 141, 144, 147, 154, 156; 18 *C. J. S.*, page 1194; 13 *Am. Jur.*, page 477; and *Pepper v. Litton*, 308 U. S. 295, 306, 307, 311, which clearly points out that dominant stockholders must act in good faith, with in-

4 Regulation 111, Sec. 29.22 (a)-22, 4 CCH Par. 86B:—"Where a person other than the grantor of property transferred in trust has a power exercisable solely by himself to vest the corpus or income therefrom in himself, the income therefrom shall be included in computing the net income of such person."

5 Compare also *Mallinckrodt v. Nunan*, 8 Cir., 146 Fed. 2d 1; *Busch v. Commissioner*, 8 Cir., 148 Fed. 2d 798.

herent fairness to the corporation, its minority stockholders, and others interested in it, cannot use their powers in disregard of the standards of common decency and honesty, cannot do indirectly through the corporation what they could not do directly, and cannot use their power for their personal advantage, no matter how absolute that power may be.[6]

Let us turn now to the powers which petitioner claims that Mr. Sunnen reserved. These are described on pages 14 and 15 of his brief. These powers were all called to the attention of the Circuit Court of Appeals, were evaluated by it, and were held to be too nebulous to justify imposition of income tax liability on Mr. Sunnen.

In addition to the reasons given by the Circuit Court of Appeals for its views, we wish to call attention to the following facts: The royalties paid were 10% of the gross sales. Mrs. Sunnen received, during the five years here involved, over $261,000.00 (R. 30). Gross sales of said machines amounted to over $2,610,000.00. These sales constituted over half of the business of Sunnen Products Company (R. 32). Mr. Sunnen owned 1,780 shares, Mrs. Sunnen owned 200 shares, and others connected with the company owned the balance of 20 shares of the company's stock (R. 26). Consequently, if Mr. Sunnen had attempted to use his voting powers to elect directors committed to a

6 That income tax liability cannot be predicated upon the power of a majority stockholder was also recognized in the following cases: *Fox v. Commissioner*, supra, where the taxpayer was sole stockholder of the corporation; *Commissioner v. Montgomery*, supra, where the taxpayer was a director, president, and owner of two out of three shares of the voting stock; *Commissioner v. Greenspun*, 5 Cir., 156 Fed. 2d 917, where the taxpayer was sole stockholder and president of the company; *Funk, W. J., v. Commissioner*, supra, where the taxpayer was a director and owned all voting stock; *Wheelock v. Commissioner*, supra, where taxpayer was president and held proxies to vote all stock; *Edward G. Swartz, Inc., v. Commissioner*, supra, where taxpayer owned all except qualifying shares; *Bear Gulch Water Co. v. Commissioner*, 9 Cir., 116 Fed. 2d 975, holding private corporation taxable on its income although all of its stock was held by a tax-exempt State University; and *Moline Properties, Inc., v. Commissioner*, 319 U. S. 436, holding corporation taxable on gains from sales made by it although one man owned all of its stock.

program of cancelling the royalty contracts, he would have harmed himself more than anyone else—would have seriously depreciated the value of his own stock.[7] Therefore, it is not realistic to assume that he would have taken such action. It is not realistic to assume that he would have been willing to thus depreciate the value of the minority stock interests. It is not realistic to assume that he would have thus jeopardized the company's power to pay its debts.[8] It is not realistic to assume that he would have thus destroyed the carefully trained organization which the company had built up.[9] It is not realistic to assume that he would have been willing to thus defraud his wife of the rights which he had given her as assignee, or to assume that she would have agreed to a course of action depriving her of over $261,000.00.

It is no answer to say, as does petitioner in footnote 5 on page 14 of his brief, that cancellation of the royalty contracts would not necessarily have been a fraud on the company, because Mr. Sunnen and the company could then have entered into contracts more favorable to it. Any such substituted contracts, if more favorable to the company, would have clearly defrauded Mrs. Sunnen of her rights as assignee of the original contracts. And we must base this case on what was done, not what might have been done.

Nor is the petitioner's case helped by saying that Mrs. Sunnen had no standing to complain of cancellation by the company, since the contracts gave it the right to cancel upon notice. Surely petitioner does not seriously believe

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7 Similar self-interest prevented application of the *Clifford* doctrine in *Wachovia Bank & Trust Company, Trustee, et al. v. Commissioner*, 3 TCM 595, 601, CCH Decision No. 14,001M, 1944 P-H, TC Memo Decision Par. 44,217; and in *Wheelock v. Commissioner*, 7 T. C. 98, 107. Moreover, for the same reasons, self-interest on the part of Mr. Sunnen would have prevented him from granting licenses to competitors of Sunnen Products Company.

8 See (R. 32) for amount of debts owed by Sunnen Products Company.

9 See (R. 32) for number of employees of Sunnen Products Company.

that these contract provisions would have prevented Mrs. Sunnen, as assignee and minority stockholder, from objecting to Mr. Sunnen arbitrarily and unfairly doing indirectly through the corporation what he could not do directly, in derogation of the interests of the corporation, its minority stockholders, and its creditors.

In effect, therefore, the petitioner bases his case on Mr. Sunnen's alleged power to wrongfully misappropriate his wife's money—to do so in violation of all standards of decency and common honesty. Petitioner's argument is substantially the same as that advanced by him in *Commissioner v. Wilcox* (327 U. S. 404, 407), but this Court rejected such argument on the ground that Wilcox had no rightful claim to the funds involved. As the Circuit Court of Appeals said in its decisions in the case at bar (R. 97), "Neither the Tax Court nor this Court should base a decision upon conjecture or possible fraud." As the Tax Court said in *Wheelock v. Commissioner*, supra (4 T. C. 98, 107), taxation should be upon a base more stable than power of a taxpayer to sabotage his company, or to make or break the business.[10]

Moreover, we wish to point out that acceptance of Commissioner's views will have far reaching and dangerous consequences. The petitioner says that Mr. Sunnen's power (as majority stockholder, as President, and as owner of property leased to the corporation) to affect the amount of income paid to his wife, is a sufficient basis for requiring him to pay a tax upon that income. But such a holding would logically require that he be taxed upon all income of the Sunnen Products Company, for he had just as much power over its entire income as he did over the 10% royalties paid by it to Mrs. Sunnen. And to hold him taxable

[10] In *Wheelock v. Commissioner*, supra, the taxpayer was president of an incorporated advertising business, and had power to vote all stock of the company.

on all of the corporation's income would clearly violate *Moline Properties, Inc., v. Commissioner*, supra, wherein even a sole stockholder was held not taxable upon the income of the corporation. Furthermore, to hold that Mr. Sunnen's alleged power to end his wife's right to receive royalties imposes tax liability upon him, logically requires that every majority stockholder be held taxable for dividends upon callable stock issued by a corporation to parties in no way connected with such majority stockholder, and be held taxable for rent paid by the corporation under cancellable leases held by strangers.

It seems to us, therefore, that petitioner's arguments obviously prove too much. They overlook the substantial adverse interests possessed by Mrs. Sunnen and others similarly situated.[11] They ignore the principle that powers which are not presently exercisable, and may never be capable of being exercised, do not exist[12]—that powers conditioned on acts which one may not be able to perform, are not the equivalent of "unfettered command."[13] They overlooked the fact that powers of control and management, no matter how unlimited and absolute they may be, are not a sufficient basis for imposition of tax liability, unless the possessor could derive economic gain from the exercise thereof. This proposition was clearly stated in

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11 An adverse interest is no less adverse because held by one's wife. Her identity cannot be merged with that of her husband. The history of divorce courts, and the modern tendency toward recognition of separate legal rights in wives, opposes such an approach. *Wheelock v. Commissioner*, supra. See also *Commissioner v. Branch*, 1 Cir., 114 Fed. 2d 985, 987, pointing out that the Clifford Doctrine does not obliterate the separate legal personality of a wife; and *Backus, Est. of Standish v. Commissioner*, 6 TC 1036, 1046, CCH Decision No. 15,142, holding that a husband is not the alter ego of his wife. The presence of adverse interests prevented application of the Clifford Doctrine in *Commissioner v. Betts*, 7 Cir., 123 Fed. 2d 534, 537-540; and *Commissioner v. Katz*, 7 Cir., 139 Fed. 2d 107, 110. Compare also *Reinecke v. Northern Trust Co.*, 278 U. S. 339, 346, holding that power to revoke a trust, with consent of a person having an adverse interest, does not prevent the immediate shifting of economic benefits.

12 *Corning v. Commissioner*, 6 Cir., 104 Fed. 2d 329, 332, citing 1 Sugden on Powers, 3d Am. Ed. 371, 372.

13 *Shanley v. Bowers*, 2 Cir., 81 Fed. 2d 13, 15.

Commissioner v. Wilcox, supra, wherein this Court said that the very essence of taxable income is the accrual of some gain, profit, or benefit to the taxpayer, and that mere dominion over money or property is not decisive in all cases.[14]

In addition, it is not reasonable, just, or expedient to the government, to impose income taxes upon Mr. Sunnen in respect of income which he can never use to pay such taxes. Such taxation violates the principle that graduated income taxes should be levied according to ability to pay. Such taxation violates *Hoeper v. Tax Commission*, 284 U. S. 206, 215, holding it unconstitutional to tax one person upon the income of another. And, such taxation seriously jeopardizes the Government's ability to collect its taxes (especially when tax rates reach 91%)—a matter which is just as important as the proper assessment of taxes. No doubt these considerations cause Congress to refuse to tax husband and wife as one, though urged to do so.[15] No doubt these considerations caused Congress to refuse to make the family the taxable unit, and caused it to permit a taxpayer to minimize his taxes by making gifts of income-producing property to others, including members of his family.[16]

For these reasons, we submit that the rights and powers acquired by Mrs. Sunnen were of far greater magnitude than those possessed by her husband, that he cannot fairly

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14 See also *Jones v. Norris*, 10 Cir., 122 Fed. 2d 6, 11; *Commissioner v. Betts*, 7 Cir., 123 Fed. 2d 534, 537; *Cushman v. Commissioner*, 2 Cir., 153 Fed. 2d 510, 513, 514. Compare the following cases where the Clifford Doctrine was not applied despite broad powers of control and management possessed by settlor: *Commissioner v. Branch*, 1 Cir., 114 Fed. 2d 985, 987; and *Suhr v. Commissioner*, 6 Cir., 126 Fed. 2d 283, 287.

15 See Revenue Bill of 1941, H. R. 5417, as introduced, 77th Cong., First Session, Sec. 111; H. Rep. No. 1040, 77th Cong., First Session, p. 10, Cong. Rec., Vol. 87, Part 6, pp. 6727-6732; "Mandatory Joint Returns," Joint Committee on Internal Revenue Taxation, U. S. Government Printing Office, 1941.

16 *U. S. v. Morse*, 159 Fed. 2d 142, 143.

be treated as the full owner of property which his wife could freely sell or otherwise dispose of, and that the Circuit Court of Appeals decision in the case at bar does not violate *Helvering v. Clifford*, supra. Every possible argument for using that case to justify taxing Mr. Sunnen upon these royalties, can be repeated with greater force and effect to justify taxing such income to Mrs. Sunnen.

C. *Earned Income.*

As pointed out above, the petitioner contends that Mr. Sunnen's patents and patent applications produced the royalty income here involved. However, he apparently also contends that these royalties were income earned by Mr. Sunnen, for he cites, on page 11 of his brief, *Lucas v. Earl*, 281 U. S. 111, and *Commissioner v. Tower*, 327 U. S. 280. These contentions are inconsistent.

Moreover, any claim that these royalties constitute earned income of Mr. Sunnen is obviously absurd. The royalties were but a part of the income earned by Sunnen Products Company, which supplied the labor and capital necessary to manufacture and sell the grinding machines—a fact always recognized by petitioner when requiring Sunnen Products Company to pay taxes upon its income. Customers of Sunnen Products Company bought and paid for the machines, not services rendered by Mr. Sunnen.

In Mr. Sunnen's prior case the Board of Tax Appeals recognized these facts, also pointed out that the royalties did not represent payment for services rendered by Mr. Sunnen to Sunnen Products Company, and distinglished *Lucas v. Earl*, supra (R. 58-59). *Lucas v. Earl*, supra, was also distinguished by the Circuit Court of Appeals in the case at bar (R. 95).

For the same reasons, *Commissioner v. Tower*, supra, is distinguishable, because in that case the evidence amply

justified the Tax Court's holding that the income was in fact earned by the husband (327 U. S. at page 284). Moreover, the *Tower* case is distinguishable on the ground that Mr. Tower never executed a completed gift of property to his wife (327 U. S. at page 283), whereas, in the case at bar, the validity of Mr. Sunnen's gift is conceded.

SECOND: **The Judgment of the Circuit Court of Appeals Reflects No Abuse of Its Power to Review the Decision of the Tax Court.**

As an afterthought, occurring after the rendition of the Circuit Court of Appeals' decision, the petitioner contends that the judgment of that Court reflects an abuse of its power to review the decision of the Tax Court.

However, the Circuit Court of Appeals did not overlook the doctrines enunciated in *Dobson v. Commissioner*, 320 U. S. 489, 501, rehearing den. 321 U. S. 231, and companion cases. In its opinion it distinguished the *Dobson* case, stating:

> "If, therefore, the finding of the Tax Court that Sunnen could control or defeat the payment of royalties to his wife be considered a finding of fact it is without 'warrant in the record,' and if it be regarded as a conclusion of law it is without 'any reasonable basis in the law'" (R. 98).[17]

If the finding of the Tax Court be one of fact, it may be reviewed because it is without warrant in the record. Under such circumstances the Appellate Court may draw its own inferences, and make its own conclusions. *Hatfried, Inc., et al. v. Commissioner*, decided June 11, 1947, 3 Cir., ... Fed. 2d ..., CCH 1947 Standard Federal Tax Reporter,

[17] The language used is correctly quoted from the typewritten opinion of the Circuit Court of Appeals. The same language appears in *Sunnen v. Commissioner*, 8 Cir., 161 Fed. 2d 171, at p. 177. The Record, on p. 98, is erroneously printed.

Vol. 4, Par. 9294, at page 12,647;[18] and *Commissioner v. Scottish American Investment Co., Ltd.*, 323 U. S. 119, 124. *Certainly these rules apply where the Tax Court's finding in the case at bar is exactly contrary to its finding in Mr. Sunnen's prior case.*

In our opinion, however, the Tax Court's finding was one of law.

In the case at bar the Tax Court, following *Dodson, Estate of J. G. v. Commissioner*, 1 T. C. 416, 423, found that cancellation by a corporation of a contract was equivalent to unilateral action by its majority stockholder. This finding involved erroneous application of the law regulating the rights and duties of majority and minority stockholders, and the rights and duties of assignors and assignees of property. The Tax Court thus committed errors of law. Its decision was mere fiating, and may be reversed. *Commissioner v. Greenspun*, 5 Cir., 156 Fed. 2d 917, 921. Compare *Howell Turpentine Company v. Commissioner*, 5 Cir., ... Fed. 2d ..., 474 CCH, Par. 9281, at page 12,610, holding that if the Tax Court's finding would not have been made but for misconceptions of law, the Appellate Court may review and reverse the case.

The Tax Court's ultimate finding that Mr. Sunnen remained in substance the owner of the income-producing property, being based upon the construction and effect of written instruments, presents a pure question of law. *Commissioner v. Wilson*, 7 Cir., 125 Fed. 2d 307, 309; and *Sunderland v. Commissioner*, 3 Cir., 151 Fed. 2d 675, 679. To the same effect, although not stressing the importance of written instruments, are *Hallowell v. Commissioner*, 3 Cir., 160 Fed. 2d 536, 538; *Hawkins v. Commissioner*, 5 Cir., 152 Fed. 2d 221, 223; and *Armstrong v. Commis-*

[18] Hereinafter, for the sake of brevity, the 1947 CCH Standard Federal Tax Reporter, Vol. 4, is cited "474CCH".

sioner, 10 Cir., 143 Fed. 2d 700, 701. Compare *Thornley v. Commissioner*, 3 Cir., 147 Fed. 2d 416, 420, in which the Court held that if the taxable consequences of a transfer of property had to be determined from various written instruments, the question was one of law—citing the following language from *Helvering v. Tex.-Penn. Co.*, 300 U. S. 481, 491:

> "The ultimate finding * * * is a conclusion of law or at least a determination of a mixed question of law and fact. It is to be distinguished from the primary, evidentiary, or circumstantial facts. It is subject to judicial review, and on such review the court may substitute its judgment for that of the Board."[19]

The Tax Court's finding, that Sec. 22 (a) of the Internal Revenue Code as construed in *Helvering v. Clifford*, supra, required Mr. Sunnen to be treated as a substantial owner of the income-producing property, was necessarily based on the theory that he could, through devious and indirect means, wrongfully misappropriate his wife's royalties. In *Commissioner v. Wilcox*, supra, this Court held that whether the substantial ownership doctrine, derived from Sec. 22 (a) as construed in *Helvering v. Clifford*, supra, could be based upon the power or act of misappropriating the funds of another, was a pure question of law (327 U. S. at pages 407 and 410).

The petitioner contended before the Tax Court in the case at bar, and the Tax Court found, that the purpose and intent of Sec. 22 (a) of the Internal Revenue Code (and similar sections of prior Revenue Acts), as construed in *Helvering v. Clifford*, supra, required the holding that

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[19] The following cases also hold that the construction, effect and interpretation of written instruments involved a question of law: *Crowe v. Geary State Bank*, 123 Fed. 2d 513, 516; *People v. Marsicano*, 135 P. 2d 16, 20, 57 Calif. App. 2d 591; *Horvath v. Sheridan, Wyoming Coal Co.*, 131 P. 2d 315, 321, 58 Wyo. 211; *Atwood v. City of Boston*, 37 N. E. 2d 131, 134, 310 Mass. 70; *Solace v. T. J. Moss Tie Co.*, 142 S. W. 2d 1079, 1081; *Battista v. Horton, Myers & Raymond*, 128 Fed. 2d 29, 31.

Mr. Sunnen was taxable upon this income. In *Bingham v. Commissioner*, 325 U. S. 365, and *McWilliams v. Commissioner*, ... U. S. ..., 91 L. Ed. 1383, 1388, this Court held that a determination of the purpose of a Section of the Internal Revenue Code raises a reviewable question of law.[20]

In the case at bar there was no conflict in the evidence. The only question involved was the legal effect of admitted facts. This is a question of law. *Nelson v. Montgomery Ward and Company, Inc.*, 312 U. S. 373, 376.[21]

The Tax Court based its decision in the case at bar upon its own decision in *Dodson, Estate of J. G., v. Commissioner*, supra (R. 72). The *Dodson Estate* case was decided as it was, out of deference to *Helvering v. Clifford*, supra. A decision of the Tax Court, which misinterprets or misapplies a prior decision of this Court, involves a reviewable question of law. *Merten's "Law of Federal Income Taxation,"* Vol. 9, pocket supplement, Sec. 51.19, p. 101; and *Denholm & McKay Realty Company v. Commissioner*, 1 Cir., 139 Fed. 2d 545, 550.[22] Certainly this rule applies to a case such as the case at bar, where the

20 See also *Lincoln Electrical Co. v. Commissioner*, 6 Cir., ... Fed. 2d ...., 474 CCH, Par. 9282, at page 12,614, interpreting the *Bingham* case, supra, and pointing out that the power to review decisions of the Tax Court has been broadened by the Administrative Procedure Act (5 U. S. C. A., Sec. 1001, et seq.). Compare *Crane v. Commissioner*, ... U. S. ....., 91 L. Ed. 931, 938.

21 See also *Farmer v. Commissioner*, 10 Cir., 126 Fed. 2d 542, 543, holding that where there is no conflict in the evidence, the legal conclusions to be drawn therefrom present questions of law; *Wolkowsky v. Goodkind*, 14 So. 2d 398, 402, 153 Fla. 267, holding that the legal effect of evidence is a question of law; *Blank v. Coffin*, 126 P. 2d 868, 870, 20 Calif. 2d 457, holding that whether a particular inference can be drawn from certain evidence is a question of law; *Titus v. Stouffer*, 40 N. E. 2d 178, 183, holding that if the facts are admitted, a question of law is presented; and *Howard v. Texas Owyhee Mining and Development Co.*, 115 P. 2d 749, 754, 62 Idaho 707, holding that proper application of law to undisputed facts involves a question of law.

22 Compare *Commissioner v. U. S. Trust Company*, 2 Cir., 143 Fed. 2d 243, 245, where the Tax Court's decision was reversed because of misconstruction of *Helvering v. Enright*, 312 U. S. 636; and *Hawkins v. Commissioner*, supra, where the Tax Court was reversed because of misapplication of previous decisions of the Circuit Courts of Appeal.

facts are so radically different from those involved in the *Clifford* case, and where the Internal Revenue Code contains no guides.

The three Circuit Court of Appeals cases cited by the Commissioner on page 17 of his brief[23] are distinguishable from the case at bar. All of them involved radically different facts. None of them involved erroneous application, or failure to apply, fundamental legal principles. None of them involves a finding of ownership based upon power wrongfully to misappropriate the funds of another. They merely hold that where the facts furnish ample and substantial support for the Tax Court's finding, that finding will not be reversed. Such is not true in the case at bar. Moreover, contrary to petitioner's claim, none of these three decisions contained one word in support of the proposition that the ultimate finding of substantial ownership is a question of fact, and not a question of law.

Likewise, *Helvering v. Clifford*, 309 U. S. 331, and *Helvering v. Stuart*, 317 U. S. 154, cited on page 17 of petitioner's brief, are not in point. Both of them were decided before *Dobson v. Commissioner*, 320 U. S. 489, and furnish no aid in applying the *Dobson* rule.

For all of these reasons we submit that the Circuit Court of Appeals' decision in the case at bar involves no abuse of its powers of review.

THIRD: **The Case at Bar Presents No New Question of Law Requiring Consideration by This Court.**

The basic question involved in this case is whether or not the admitted owner of property is taxable upon income produced thereby. This question has been answered in

[23] *Hash v. Commissioner*, 4 Cir., 152 Fed. 2d 722; *Eisenberg v. Commissioner*, 3 Cir., 161 Fed. 2d 506, cert. applied for; and *Littel v. Commissioner*, 154 Fed. 2d 922, 2 Cir.

the affirmative ever since the inception of taxes upon income. Such an answer was expressly approved by this Court in *Hoeper v. Tax Commission*, supra; *Blair v. Commissioner*, supra, and *Pearce v. Commissioner*, supra. No reason exists for this Court to again pass upon so elementary a matter.

Nor will the decision of the Circuit Court of Appeals in the case at bar stimulate any tax saving plans. Here, the assignor happened to be a majority stockholder of a corporation, and the assignee happened to be a minority stockholder. These facts are peculiar to this case. Similar facts are not likely to occur again. Moreover, the petitioner's claim that the Circuit Court of Appeals' decision will start a tax saving crusade is belied by the fact that he sought no review of the exactly comparable decision rendered by the Board of Tax Appeals in 1935 (R. 60).

CONCLUSION.

It is, therefore, respectfully submitted that this case is not a proper one for review by certiorari in this Court, and that the petition for a writ of certiorari should be denied.

C. P. FORDYCE,
Counsel for Respondent.

Dated August 15, 1947.

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No. 227.

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1947.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

JOSEPH SUNNEN,
Respondent.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

BRIEF FOR THE RESPONDENT.

C. POWELL FORDYCE,
506 Olive Street,
St. Louis 1, Missouri,
Counsel for Respondent.

St. Louis Law Printing Co., 415 North Eighth Street. CEntral 4477.

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No. 227.

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1947.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

JOSEPH SUNNEN,
Respondent.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

BRIEF FOR THE RESPONDENT.

I.

STATEMENT OF THE CASE.

Petitioner's statement contains no reference to the following facts which we deem pertinent:

The directors of Sunnen Products Company (except Joseph Sunnen), authorized the officers of the company

to enter into all royalty-license agreements involved in this case (R. 31).

On June 29, 1935 the Board of Tax Appeals held that Mr. Sunnen was not liable for income taxes on cylinder grinder royalties paid by Sunnen Products Company to Mrs. Sunnen during 1929, 1930 and 1931. In its decision the Board pointed out that the cylinder grinder royalty contract was an assignable property right, that the assignment by Mr. Sunnen of all of his right, title, and interest in and to that contract to Mrs. Sunnen vested title to the income-producing property in her, and that the royalty contract, and not Mr. Sunnen, produced the royalty income (R. 53-60).

This decision was rendered prior to the assignments by Mr. Sunnen of the renewal cylinder grinder royalty contract, and the assignment by him of all of his interest in the crank shaft grinder royalty contract.

The manufacture and sale by Sunnen Products Company of the patented cylinder grinder, pin-hole grinder, and two crank shaft grinders, pursuant to the royalty-license agreements executed by it and Mr. Sunnen, constituted more than half of the business of that company (R. 32).

The company employed from 90 to 220 persons, and paid them wages varying from approximately $189,000.00 per year to approximately $372,000.00 per year (R. 32).

The company owed its creditors amounts varying from approximately $123,000.00 to $574,000.00 (R. 32).

Mrs. Sunnen possessed a large independent fortune (R. 52).

Judge Van Fossan of the Tax Court, who heard the case at bar, dissented from the opinion of the majority of the court (R. 72).

II.

QUESTIONS PRESENTED.

Since the record contains no evidence of Mr. Sunnen's motive for assigning the royalty contracts to his wife, we deem it improper for the petitioner, on page 2 of his brief, to infer that Mr. Sunnen made such assignments to avoid income taxes.

It is our opinion, therefore, that the questions presented in this case should be stated as follows:

1. Whether a majority stockholder of a corporation, who owns patent applications and patents, who then enters into royalty-license contracts with the corporation for the manufacture and sale of the inventions, who subsequently assigns all of his right, title, and interest in and to such contracts to a minority stockholder of the corporation, and who thereafter notifies the corporation of such assignments, is taxable upon the royalties later paid by the corporation to the assignee.

2. Whether the decision rendered by the Board of Tax Appeals in 1935 forms the basis of applying the doctrine of res adjudicata, or the doctrine of stare decisis, as to (a) cylinder grinder royalties paid to Mrs. Sunnen in 1937 under the same contract and assignment involved in Mr. Sunnen's prior Board of Tax Appeals decision and (b) cylinder grinder and other royalties paid to Mrs. Sunnen, during the period 1937-41, both inclusive, under royalty agreements and assignments similar in all material respects to the instruments involved in Mr. Sunnen's Board of Tax Appeals decision.

3. Whether or not the petitioner determined the deficiencies for 1937 and 1938 within the time prescribed by Sec. 275 (a), Revenue Acts of 1936 and 1938 (26 U. S. C. A., "Internal Revenue Acts," pp. 918, 1108), as extended by consents executed by the parties (R. 46-50).

III.

SUMMARY OF ARGUMENT.

I. The petitioner contends that, since Mr. Sunnen owned a majority of the stock of Sunnen Products Company, he could elect directors of the company, cause such directors to vote to cancel the royalty contracts previously executed by him and the company and assigned by him to his wife, and thus terminate the receipt of the royalties by her. Such power, the petitioner alleges, was equivalent to unilateral action on the part of Mr. Sunnen. If the petitioner's view is sound—if these royalties were thus subject to Mr. Sunnen's unfettered command—he should prevail upon the authority of *Corliss v. Bowers*, 281 U. S. 376. However, we contend that after Mr. Sunnen assigned the royalty contracts to his wife, and notified the company of such assignments, she, as assignee, under generally recognized principles of the law of assignments, could protect herself by legal action against any act of dominion by Mr. Sunnen over the contracts tending to deprive her of her rights, and could protect herself against any collusive action by him and the company tending to defeat her rights. We contend, further, that as Mrs. Sunnen was a substantial minority stockholder of the company when the royalty contracts were assigned to her, she could, as such stockholder, and by appeal to courts of law or equity, prevent Mr. Sunnen, as majority stockholder, from taking any action which was not inherently fair to the company and to Mrs. Sunnen and the other minority stockholders, and which was not in accordance with the standards of common decency and honesty. She could prevent him from doing anything indirectly through the corporation which he could not do directly. As majority stockholder Mr. Sunnen had no greater rights to the property of the company than Mrs. Sunnen and other minority stockholders. Therefore, if

Mr. Sunnen had sought to force the company to cancel the royalty contracts, which were the source of over half of its profitable business, or if he had sought to force the company to cease manufacturing under such contracts upon his promise to grant other licenses to the company in consideration of royalties payable to him, instead of to his wife, she could easily have blocked his action and protected her adverse interest. Mr. Sunnen's control was definitely less than that of the embezzler, Wilcox, involved in *Commissioner v. Wilcox*, 327 U. S. 404; and yet this court refused to tax Wilcox on sums embezzled by him because he, like Mr. Sunnen, had and could have no bona fide legal or equitable claim to the funds involved. Mr. Sunnen could have received no gain or profit from arbitrarily and wrongfully forcing the company to cancel the royalty contracts. The company could not, in good faith, cancel the contracts unless the manufacture and sale of these grinding machines was unprofitable to it; and Mr. Sunnen alone could not cause such manufacture and sale to be profitable or unprofitable. *Blair v. Commissioner*, 300 U. S. 5, governs this case.

To buttress his argument the petitioner claims that the underlying patents which Mr. Sunnen continued to own, and not the royalty contracts which he assigned to his wife, produced the royalty income here involved. He cites no authority for this proposition. This argument was rejected upon ample authority by the Board of Tax Appeals in a prior case involving Mr. Sunnen and by the Circuit Court of Appeals in the case at bar. Even the Tax Court in the case at bar did not adopt this contention. Moreover, the petitioner's argument conflicts with numerous decisions, never repudiated by this court, which clearly hold that contracts calling for the payment of income produce such income. The royalty contracts here involved are analogous to leases, and in *Helvering v. Horst*, 311 U. S.,

at p. 119, this court pointed out that rent from a lease is not income of a donor after he has made a gift of the lease. In addition, to hold that the patents, and not the royalty contracts, produced the royalties would lead to absurd tax results.

The petitioner further contends that Mr. Sunnen's control over the patents, and his power as majority stockholder of the company, brings his case within the ambit of *Helvering v. Clifford*, 309 U. S. 331. We contend otherwise. No trust is here involved. A regularly organized and operated business corporation is not a trust. Mr. Sunnen's rights do not coincide substantially with the normal concepts of full ownership. Mrs. Sunnen acquired, by virtue of the assignments, rights of far greater magnitude than those of her husband. Her rights were not insignificant. Mrs. Sunnen acquired full right to sell, pledge, or give away the royalty contracts—rights which Mrs. Clifford did not have. Such rights, under the petitioner's own regulations, usually cause the Clifford doctrine to be applied to tax the donee, not the donor. Unlike the Clifford case, the case at bar involves no reverter to the grantor, and no "short-term" arrangement. The petitioner's argument that Mr. Sunnen could license competitors of the company, and thus diminish his wife's royalties, is pure speculation. The petitioner pitches his case on an alleged power of Mr. Sunnen to misappropriate his wife's money, in violation of all standards of common decency and honesty. No decision should be based on possible fraud. Taxation should be upon a basis more stable than power of a taxpayer to sabotage a family company, or to make or break the business. Mr. Sunnen's alleged power to manage such business is not the control to which the Clifford case refers. The Clifford case does not merge the separate legal personality of a wife, espe-

cially when her property rights over the property involved are of greater magnitude than the rights of her husband. Every possible argument for applying the Clifford case to justify taxing these royalties to Mr. Sunnen, can be repeated with greater force as a reason for taxing them to Mrs. Sunnen.

The petitioner appears to contend also, and rather inconsistently, that these royalties were income earned by Mr. Sunnen. This view is clearly erroneous. Customers of the company bought and paid for grinding machines and not services of Mr. Sunnen. *Lucas v. Earl*, 281 U. S. 111; *Commissioner v. Tower*, 327 U. S. 280, and *Lusthaus v. Commissioner*, 327 U. S. 293, are readily distinguishable.

II. The petitioner opposes, and we urge, that the doctrine of res judicata, or the doctrine of stare decisis, is applicable. The same parties, and the same questions, were involved in Mr. Sunnen's prior case, wherein the Board of Tax Appeals held Mr. Sunnen not to be liable for cylinder grinder royalties paid to his wife in 1929, 1930 and 1931. The years here involved are 1937-41, both inclusive. As to the cylinder grinder royalties paid in 1937 under the same royalty contract which was involved in the prior case, our views prevailed in the case at bar before the Tax Court, and the Circuit Court of Appeals. The Tax Court rejected our views as to royalties paid in 1938 and thereafter under a renewal of the aforesaid cylinder grinder royalty contract, and as to other royalties paid under royalty contracts similar in all material respects to the original cylinder grinder royalty contract which was involved in Mr. Sunnen's prior case. We respectfully contend that as to these other royalties the Tax Court in the case at bar unduly stressed the evidence and ignored the applicable and settled legal principle established by the Board of Tax Appeals in Mr. Sunnen's prior decision.

III. The burden of proof, as to Mr. Sunnen's liability for income taxes on royalties paid in 1937 and 1938, must be borne by the petitioner. If he has not borne such burden, his determination of the deficiencies for those years was made after the expiration of the applicable statutes of limitation. If he has borne such burden, this question should be ruled against us. If we are right on the merits of the case, this point should be ruled against the petitioner.

ARGUMENT.

I.

THE INCOME IN QUESTION IS NOT TAXABLE TO THE ASSIGNOR OF THE INCOME-PRODUCING PROPERTY, BUT TO THE ASSIGNEE.

Mr. Sunnen invented certain grinding machines and subsequently applied for patents thereon. After making such applications, and before patents were issued, he entered into royalty-license agreements with Sunnen Products Company. These agreements authorized the company to manufacture and sell the grinding machines in the United States and foreign countries, in consideration of the payment of a ten per cent royalty to Mr. Sunnen. Two of the contracts could be cancelled by either party on six months' written notice; and two could be cancelled on one year's written notice. Immediately after executing such contracts Mr. Sunnen assigned all of his right, title, and interest in and to said contracts to his wife, and duly notified the company of his action. When these events took place Mr. Sunnen owned a majority of the stock of Sunnen Products Company, his wife owned a substantial minority stock interest, the vice-president of the company owned a substantial minority stock interest, and two other officials of the company owned one share each. These five individuals were directors of the company, and no action binding upon the company could have been taken except by vote of three of such directors (R. 32). The manufacture and sale of these grinding machines constituted more than half of the business of the company (R. 32). In connection with this business the company employed between 90 and 220 persons, and incurred substantial debts (R. 32). No notices to cancel the royalty agreements were given or received by either party, and the

agreements remained in effect during the years here involved (R. 31).

Is such an assignor taxable upon royalties paid to the assignee?

A. The decision of the Tax Court in the Estate of J. G. Dodson v. Commissioner, 1 T. C. 416, is not controlling.

In support of his contention that Mr. Sunnen is liable for income taxes on these royalties, the petitioner cites *Estate of Dodson v. Commissioner*, supra. As shown on pages 14 and 15 of his brief, the Tax Court decided against the Dodson Estate because of Dodson's alleged power, as majority stockholder, to cause the corporation to cancel the royalty contract previously executed by him and it. This power, the Tax Court said, was equivalent to "unilateral action" by Dodson. Consequently, the Tax Court determined that even after Dodson assigned a one-half interest in the royalty contract to his wife, he remained the owner of the entire royalty contract for all substantial and practical purposes.

We contend that the Dodson case is distinguishable because it involved no independent directors and stockholders; and that it is clearly wrong.

We also contend that the Tax Court's decision in Mr. Sunnen's case is clearly wrong.

In its decision in the case at bar the Tax Court overlooked entirely the control and powers which Mrs. Sunnen acquired as assignee of the royalty contracts, to-wit: (1) Her power to sell or give away the royalty contracts immediately after she had received the assignments thereof, (2) her power to cancel the contracts upon notice, (3) her power, with the consent of the company, to alter or amend the royalty contracts, (4) her power to sue the

company for breaches of said contracts, etc. Moreover, the Tax Court overlooked entirely the control and powers which Mrs. Sunnen possessed as a substantial minority stockholder of Sunnen Products Company. The Tax Court did not weigh these powers of Mrs. Sunnen with the alleged power of Mr. Sunnen. The Tax Court saw only his power as majority stockholder, and concluded that he and the corporation could cancel the royalty contracts. Such power, in the Tax Court's opinion, was equivalent to unilateral action on Mr. Sunnen's part.

We deny that Mr. Sunnen had power to force Sunnen Products Company to cancel the royalty contracts. His voting rights as majority stockholder do not permit him to thus ride roughshod over the rights possessed by his wife, as assignee of the royalty contracts, and as a substantial minority stockholder of the corporation.

In regard to Mrs. Sunnen's rights as assignee of the royalty contracts, we respectfully call attention to the following language used in 6 *Corpus Juris Secundum:*

> "The assignment of a contract operates not merely as an assignment of the moneys thereafter to be earned, but of the whole contract, with its obligations and burdens. * * * (Sec. 84, p. 1142).
>
> "Unless a contrary intention is manifest or inferable, an assignment ordinarily carries with it all rights, remedies, and benefits which are incidental to the things assigned; * * *." (Sec. 85, p. 1142).
>
> **"The assignor, after an unqualified assignment and notice to the debtor, usually loses all control over the chose and can do nothing to defeat the rights of the assignee"** (Sec. 96, p. 1152).
>
> "Although the original parties may make a binding compromise or settlement before the debtor has been notified of the assignment, after notice has been given of an unqualified and absolute assignment, they cannot do so, nor can the assignor release or extinguish the debt assigned" (Sec. 97, p. 1153).

"As the assignment passes all the assignor's title or interest to the assignee * * *, **and divests the assignor of all right of control over the subject matter of the assignment** * * *, it is usually held that by the mere fact of the assignment the assignor impliedly guarantees or agrees that he will not thereafter interfere with the thing assigned, and, if he does interfere to the damage of the assignee, he renders himself liable to the assignee for any damage resulting from such interference. **Any act of dominion by the assignor over the thing assigned, depriving the assignee of title or right to possession, is a conversion** for which the assignor may be held liable in tort; and, if the assignor proceeds to collect the sum due on an assigned chose the moneys so coming into his hands are regarded as trust funds belonging to the assignee, who may recover the same either in an action for money had and received or in tort for conversion" (Sec. 101, p. 1158). (Emphasis supplied.)

Likewise, in 4 *American Jurisprudence*, p. 312, it is said:

"Sec. 105. Protection of assignee against acts of the assignor * * *. **In courts of law as well as in those of equity, after notice to the debtor of an assignment, the interest of a bona fide assignee of a chose in action will be protected against any unauthorized act on the part of the assignor tending to interfere with the rights of the assignee.** This protection extends to the nullifying of collusive agreements of the assignor and debtor to defeat the rights of the assignee." (Emphasis supplied.)

See also *P. N. Gray & Company, Inc., v. C. A. Valliotis*, 276 Fed. 565, 569, affirmed 293 Fed. 1018, holding that by an assignment of a contract the assignor contracts that he will do no act to deprive the assignee of his rights under the assigned contract.

Missouri law, which governs Mrs. Sunnen's rights under these assignments, applies these general principles. *Houser*

v. Richardson, 90 Mo. App. 134; *Leahy v. Dugdale*, 41 Mo. 517; *Lord v. Schamloeffel*, 50 Mo. App. 360; *Buffington v. South Missouri Land Company*, 25 Mo. App. 492.

These authorities clearly show, we think, that Mrs. Sunnen could obtain relief from a court of equity to protect her against any collusive or arbitrary action taken by Mr. Sunnen, through Sunnen Products Company, to defeat her rights.

Nor could Mr. Sunnen, by exercising his rights as majority stockholder, arbitrarily cause the corporation to cancel the royalty agreements, thereby forcing it to lose over half of its profitable business, and thus seriously depreciating the value of Mrs. Sunnen's stock. This is shown by the following authorities:

13 *Fletcher, "Cyclopedia of the Law of Private Corporations"*:

> (Page 137) "If the corporate officers or majority stockholders threaten or commit acts which constitute a breach of trust, or are fraudulent or unfair or otherwise wrongful, even if the acts are not beyond the powers of the corporation nor positively forbidden by statute or public policy, minority stockholders may sue to prevent or redress such injuries, * * *."
>
> (Page 141) "Equity will never countenance any scheme to defraud, no matter how novel and ingenuous. Actual dishonesty of those in control is not necessary."
>
> (Page 144) "A majority of the stockholders, no matter how large, have no right to divert assets of the company to the detriment of minority stockholders, and if they do so relief may be granted to minority stockholders."
>
> (Page 147) "If the owners of a majority of the stock of a corporation take advantage of their posi-

tion and of their influence over the directors or other officers, to obtain an inequitable contract with or conveyance or lease from the corporation, they perpetrate a fraud upon the minority, and the contract, lease, or conveyance will be set aside in equity at the suit of dissenting stockholders."

(Page 154) "A stockholder may sue to enforce a contract which has been fraudulently rescinded or fraudulently broken by anticipation."

(Page 156) "Management of the corporation by those in control, for their own interest or profit, to the exclusion of minority stockholders, is ground for relief."

18 *Corpus Juris Secundum*, p. 1194:

"The ownership of a majority of the stock gives the holder no greater right to the property of the corporation than if he owned a small percentage of the shares."

13 *American Jurisprudence*, p. 477:

"Majority stockholders will not be permitted to discontinue the business of a corporation for the purpose of turning it over to another—and excluding minority stockholders from participating therein."

Pepper v. Litton, 308 U. S. 295, 306, 307, 311:

"A director is a fiduciary. *Twin-Lick Oil Co. v. Marbury*, 91 U. S. 587, 588, 23 L. ed. 329, 330. So is a dominant or controlling stockholder or group of stockholders. *Southern P. Co. v. Bogert*, 250 U. S. 483, 492, 63 L. ed. 1099, 1107, 39 S. Ct. 533. Their powers are powers in trust. See *Jackson v. Ludeling*, 21 Wall 616, 624, 22 L. ed. 492, 495. Their dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged the burden is on the director or stockholder not only to prove the good faith of the transaction but also to show its inherent

fairness from the viewpoint of the corporation and those interested therein. *Geddes v. Anaconda Copper Min. Co.*, 254 U. S. 590, 599, 65 L. ed. 425, 432, 41 S. Ct. 209. The essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain. * * *

"* * * He who is in such a fiduciary position cannot serve himself first and his cestuis second. He cannot manipulate the affairs of his corporation to their detriment and in disregard of the standards of common decency and honesty. He cannot by the intervention of a corporate entity violate the ancient precept against serving two masters. * * * He cannot violate rules of fair play by doing indirectly through the corporation what he could not do directly. He cannot use his power for his personal advantage and to the detriment of the stockholders and creditors no matter how absolute in terms that power may be and no matter how meticulous he is to satisfy technical requirements. For that power is at all times subject to the equitable limitation that it may not be exercised for the aggrandizement, preference, or advantage of the fiduciary to the exclusion or detriment of the cestuis. Where there is a violation of those principles, equity will undo the wrong or intervene to prevent its consummation."

We contend, therefore, as was said in *Flarsheim v. U. S.*, 156 Fed. (2d) 105, 108, that Mrs. Sunnen's contract rights were "an equitable charge upon the business itself which a court of equity would enforce." We contend, further, that Mrs. Sunnen could not be deprived of her rights, through cancellation of the contracts, unless and until three directors of the company in good faith determined that further performance of the royalty contracts was not profitable to Sunnen Products Company. Joseph Sunnen, alone, could not make such determination. Joseph Sunnen, alone, could not cause the company's operations to be profitable or unprofitable. Consequently, we submit that

Joseph Sunnen's alleged power to cancel the contracts was anything but equivalent to unilateral action on his part.

This is even more apparent when it is remembered that the pinhole grinder royalty contract (R. 37) and the crankshaft grinder royalty contract (R. 43) could not have been cancelled even by the corporation during any one of the years here involved. Both agreements required, for cancellation, that an advance notice of one year be given to the other party. No such notices were given (R. p. 31, par. 22). Consequently, as each year passed, without notice having been given, these agreements were not subject to cancellation by either party in the succeeding year. See *Lewis v. White*, 56 Fed. (2d) 390; *Faber v. U. S.*, 1 Fed. Supp. 859; *Langley v. Commissioner*, 61 Fed. (2d) 796; *Ashforth v. Commissioner*, 26 BTA 1188; and G. C. M. 11640, XII-1 C. B. 144, all holding that if the grantor of a revocable trust does not give the prescribed advance notice of his intent to revoke it, the trust is irrevocable during the years under consideration. It is true, of course, that we are not now considering a revocable trust. Nevertheless, the same principles regarding notice are obviously applicable. And, as pointed out in *Funk, W. J. v. Commissoner*, 3 T. C. M. 100 (CCH Dec. No. 13,727M, 1947 P-H T. C. Memo. Dec. Par. 44,030), the liability of the taxpayer "must be based upon circumstances existing in the taxable year in question."

In addition to these considerations we contend that the Tax Court's decision in Mr. Sunnen's case, and in *Estate of Dodson v. Commissioner*, supra, violates principles announced by this court in *Commissioner of Internal Revenue v. Wilcox*, 327 U. S. 404. Therein this court said that even full dominion and control of money or property is not decisive in all cases; that the very essence of taxable income is the accrual of some gain, profit, or benefit to the taxpayer;

and that without some bona fide legal or equitable claim to the funds involved, the taxpayer cannot be said to have received any taxable gain or profit. Therefore, even if we admit for the sake of argument that Mr. Sunnen could have used his power as majority stockholder to force the company to cancel the royalty contracts, it seems to us that this fact is not sufficient. Mr. Sunnen could have received no gain, profit, or benefit from such cancellation. Such cancellation would only deprive Sunnen Products Company of more than half of its business, throw many of its employees out of work, cause trouble with the company's creditors, and seriously depreciate the value of Mr. Sunnen's stock (See R. p. 32). Moreover, the exercise of such power could give Mr. Sunnen no legal or equitable claim to any royalties paid, or payable, to Mrs. Sunnen. Nor could the exercise of such power give Mr. Sunnen anything falling within the following definition of income adopted in *Eisner v. Macomber*, 252 U. S. 189, 207, "* * * something of exchangeable value * * * received or drawn by the recipient (the taxpayer) for his own separate use, benefit, and disposal." Of course, the exercise of such power might conceivably afford some vindictive satisfaction to Mr. Sunnen if his wife should divorce him. Nevertheless, as said in *Helvering v. Stuart*, 317 U. S. 154, 168:

> "Economic gain realized or realizable by the taxpayer is necessary to produce a taxable income under our statutory scheme. * * *. The 'non-material satisfaction' (gift-contributions) of a donor are not taxable as income."

We respectfully submit, also, that the Tax Court's decision in the case at bar directly conflicts with *Blair v. Commissioner*, 300 U. S. 5. In connection with the Blair case it is interesting to note that Mr. Blair, who assigned a part of his equitable interest in the corpus of a trust

created by his father's will, was also a co-trustee with his son of that trust (*Commissioner v. Blair*, 60 Fed. [2d] 340, 341; *Blair v. Commissioner*, 31 B. T. A. 1192), and that the co-trustees of such trust had broad power to control and manage the trust property (*Blair v. Commissioner*, 18 B. T. A. 69).

B. **Assignment of income or income producing property.**

On page 16 et seq. of his brief the petitioner argues that Mr. Sunnen is taxable upon the royalties paid to his wife because he did not part with the patents, and that the patents were in reality the ultimate source of the royalties.[1]

The petitioner cites no authority in support of his argument.

This argument was rejected by the Board of Tax Appeals in Mr. Sunnen's prior case (R. 59-60). The Board cited many authorities[2] including the closely analogous case of *Edward G. Swartz, Inc., v. Commissioner*, 5 Cir., 69 Fed. 2d 633, 635. In that case Mr. Swartz, who owned timber land, entered into a timber cutting contract with Bernard Cypress Company, providing for the payment to him of part of the profits derived from the cutting and sale of the timber. Subsequently, Mr. Swartz assigned all of his right, title, and interest in and to this contract to Edward G. Swartz, Inc., in exchange for all of its stock

1 This argument overlooks the fact that while the crank-shaft grinder royalty contract was assigned on June 20, 1939, and royalties were paid from that date, the two crank shaft grinder patents were not issued until May 6, 1941 and January 26, 1943, respectively (R. 29). Patents are not in existence until issued, and could not in any event produce income before they are issued. The taxable years here involved are 1937-41, both inclusive.

2 *Nelson v. Ferguson*, 3 Cir., 56 Fed. 2d 121, 124, cert. den. 286 U. S. 565 (wherein the assignee of the royalty contract had no interest whatever in the patent); *Leydig v. Commissioner*, 15 B. T. A. 124, affd. 10 Cir., 43 Fed. 2d 494; *Field v. Commissioner*, 2 Cir., 42 Fed. 2d 820, 822; *Copland v. Commissioner*, 7 Cir., 41 Fed. 2d 501, 504; *Smith et al., Extrs., v. Commissioner*, 25 B. T. A. 291; *Lowery v. Helvering*, 2 Cir., 70 Fed. 2d 713, 714.

except two qualifying shares. Swartz, however, individually retained ownership of the lands. In answer to the contention of the corporation that all income paid to it by the Cypress Company was taxable to Mr. Swartz individually, the Court on page 635 said:

> "Here the creator (Swartz) has assigned to the creature (Edward G. Swartz, Inc.) the thing itself from which the income flows. Before the assignment Swartz was the owner of the income because he owned the contract which yielded it. After the assignment the company owned the income, for after it the contract was not Swartz's but its own. The petitioner's claim that it was not the owner of the income because Swartz had not assigned to it the timber but only the contract, is without merit. The actual, the present interest in the timber, the right to have it cut and marketed, and the right to the proceeds from that cutting and marketing, Swartz, by assigning the right and title to the contract, assigned to petitioner. Unless and until there was a breach sufficient to authorize cancellation of the contract, the right Swartz had in the timber was the right to insist that it be cut as the contract provided, and that he receive for it the price the contract fixed. These rights he fully assigned to petitioner. The ownership of these rights involved, it drew to itself all that proceeded from the contract. The owner of these rights was the owner of the income they produced. Nothing in the *Earl Case* (281 U. S. 111, 74 L. Ed. 731), or in those which have followed it, makes these payments taxable to Swartz. To tax Swartz and not petitioner would, we think, be to impose a tax on one on account of the income of another." (Citing *Poe v. Seaborn*, 282 U. S. 101, 51 S. Ct. 58, 75 L. Ed. 239; *Hoeper v. Tax Commission*, 284 U. S. 206, 52 S. Ct. 120, 76 L. Ed. 248, and other cases.)

Even the Tax Court, in the case at bar, did not repudiate the principle that a contract right to a certain percentage of the royalties on an invention is itself income-producing

property and the holder of such right is taxable on the royalties paid thereunder. This is clearly shown by *Strauss v. Commissioner*, 8 T. C. No. 121, CCH Decision No. 15,787, decided May 15, 1947. In that case the Tax Court held that a husband, who helped finance the development and patenting by others of a process for making colored film known as Kodachrome, who for such financial assistance acquired a right to receive a certain percentage of royalties on and an interest in the process, and who later, as a gift, assigned to his wife (who had no interest whatever in the patents) all of his "right, title, and interest in Kodachrome," was not taxable on royalties subsequently paid to his wife. *Sunnen v. Commissioner*, 6 T. C. 431, was distinguished solely because of the alleged control possessed by Mr. Sunnen over Sunnen Products Company.

The petitioner's argument that the patent and patent applications produced the royalties paid to Mrs. Sunnen was also flatly rejected by the Circuit Court of Appeals in the case at bar (R. 95, 96).[3]

Moreover, the petitioner's argument conflicts with the fundamental principles enunciated in the following cases, which have never been repudiated by this Court: *Lilienfeld v. Commissioner*, 35 B. T. A. 391, 395 (acquiesced in by Commissioner, 1937—1 C. B. 15), (involving royalty contracts assigned to wife who had no interest in patent); *Timken, Est. of H. H. v. Commissioner*, 47 B. T. A. 494, affd. 6 Cir., 141 Fed. 2d 625 (note with past due interest assigned); *Ray, Rose L. v. Commissioner*, 1941 P-H, B. T. A. Memo. Decision Par. 41,325, CCH Decision No.

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3 The Circuit Court of Appeals cited *Commissioner v. Field*, supra; *Lowery v. Helvering*, supra; *Hall v. Burnett*, App. D. C., 54 Fed. 2d 443, 446, cert. den. 285 U. S. 552; *Nelson v. Ferguson*, supra; *Helvering v. Seatree*, App. D. C., 72 Fed. 2d 67, 68; *Shanley v. Bowers*, 2 Cir., 81 Fed. 2d 13, 15; *Commissioner v. O'Donnell*, 9 Cir., 90 Fed. 2d 907, 910, revd. on other grounds, 303 U. S. 370; *Commissioner v. Ross*, 6 Cir., 83 Fed. 2d 18, 19, 20; *Lum v. Commissioner*, 3 Cir., 147 Fed. 2d 356, 357; and *Blair v. Commissioner*, 300 U. S. 5, 13.

11874A, B. T. A. Dkt. No. 101315, decided June 26, 1941 (oil and gas leases assigned); *Commissioner v. Montgomery*, 5 Cir., 144 Fed. 2d 313, 316 (construction contract assigned to family corporation by majority stockholder); *Fox v. Commissioner*, 37 B. T. A. 271, 278 (royalty contract assigned to corporation by sole stockholder); *Montgomery v. Thomas*, 5 Cir., 146 Fed. 2d 76, 80 (stock in family corporation purchased for children by majority stockholder); *Ross, Est. of W. L. v. Commissioner*, T. C. Memo. Opinion, 2 T. C. M. 573, 575, CCH Decision No. 13,416M (contract assigned); *Allen v. First National Bank and Trust Company*, 5 Cir., 157 Fed. 2d 592 (life interest in trust corpus assigned), cert. den. on March 3, 1947, 91 L. Ed. 691; *Porter Royalty Pool, Inc., v. Commissioner*, 7 T. C. 685, 696-697, CCH Decision No. 15,362 (interest in oil leases assigned to corporation by landowner); *Funk, W. J. v. Commissioner*, T. C. Memo. Opinion, 3 T. C. M. 100, CCH Decision No. 13,727M, 1947, P-H, T. C. Memo. Decision Par. 44,030, and *Funk, E. M. v. Commissioner*, 7 T. C. 890, CCH Decision No. 15,397 (both involving stock in family corporation assigned by President and majority stockholder); and *Wheelock v. Commissioner*, 7 T. C. 98, CCH Decision No. 15,216 (stock in family corporation assigned by President and majority stockholder). Compare also *Friedman v. Commissioner*, 45 B. T. A. 976, 983, affd. 4 Cir., 130 Fed. 2d 305 (involving assigned attorney-client contract).

In addition, we desire to point out that to adopt the petitioner's argument—to hold that the patents were the income-producing property—would lead to such absurd tax results as taxing a person who might buy the patents from Mr. Sunnen on royalties paid after such purchase to Mrs. Sunnen; and taxing Mr. Sunnen, if he retained the patents, on royalties paid to one who might buy the royalty contracts from Mrs. Sunnen. The property rights involved in the patents and contracts were separate and distinct.

Clearly these royalties were produced by the royalty contracts. Without them Mr. Sunnen's patents and patent applications would not have been exploited. No labor or capital would have been used to make and sell these grinding machines, and no royalties would have been paid to anyone. Unexploited patents never produce income. The actual and present interest in the patents, the right to have the patented devices manufactured and sold, and the right to a part of the proceeds of that manufacture and sale, Mr. Sunnen, by assigning all of his interest in the royalty contracts, assigned to Mrs. Sunnen. These views, which are in accord with principles long since firmly established by this Court, were adopted by the Circuit Court of Appeals in the case at bar. In its opinion the Circuit Court of Appeals said:

> "Unlike the transactions involved in *Helvering v. Horst*, supra; *Harrison v. Schaffner*, supra, and other cases cited supra, here the assignments of the royalty contracts were conveyances *in praesenti* of vested income-producing property rights. They were not mere gifts of money payable in the future from the earnings of the donor or from income-producing property owned by him. A royalty contract resembles a lease of real property, and the royalties payable thereunder are analogous to rent. Had the royalty contracts not been assigned in the present case the royalties when paid to Sunnen would have been income taxable to him, the same as rents are taxable to the landlord. *Burnet v. Harmel*, 287 U. S. 103, 108. After the assignments the royalties were 'no more the income of the donor than would be the rent from a lease or a crop raised on a farm after the leasehold or the farm had been given away.' *Helvering v. Horst*, supra, 311 U. S., at page 119" (R. 96).

Nevertheless, in footnote 4 on page 21 of his brief, the petitioner seeks to avoid the clear language used by this Court in the *Horst* case, supra. He argues that for a land-

owner to be relieved from income taxes on rent paid under a lease assigned by him, the landowner must also assign his entire interest—the land as well as the lease. This argument is directly contrary to *Lum v. Commissoner*, supra; *Edward G. Swartz, Inc., v. Commissioner*, supra, and *Porter Royalty Pool, Inc., v. Commissioner*, supra. Compare also *J. S. Abercrombie Co. v. Commissioner*, 7 T. C. 120, affd. by the Circuit Court of Appeals of the Fifth Circuit on June 25, 1947, 162 Fed. 2d 338, 1947 CCH Standard Federal Tax Reporter, Vol. 4, Par. 9301, holding that assignees were taxable upon income accruing to their interests under assigned oil and gas leases, despite reservations of capital investment in minerals by the assignors.

C. **The Clifford doctrine is not applicable.**

While conceding the truth of the general proposition that the owner of property is no longer taxable upon the income therefrom after he has disposed of the property itself,[4] the petitioner argues that he may still be accountable for tax upon such income where he has retained incidents of ownership in the underlying property, particularly where the income is merely reallocated within the family group. In support of his argument the petitioner cites *Helvering v. Clifford*, 309 U. S. 331, which involved a short-term family trust, non-assignability of interest by the beneficiary, reverter to the grantor, and broad powers of control and management without liability vested in the grantor-trustee of such trust. The petitioner makes this contention despite the fact that no trust is involved in the case at bar and the Circuit Court of Appeals of the Fifth Circuit in *Commissioner v. Montgomery*, 144 Fed. 2d 313, 316, said: "*A lawfully organized and operated busi-*

[4] This concession must be made in view of *Pearce v. Commissioner*, 315 U. S. 543, 554, in which this court limited the application of *Helvering v. Horst*, 311 U. S. 112; *Helvering v. Eubank*, 311 U. S. 122, and *Harrison v. Schaffner*, 312 U. S. 579.

ness corporation is not the equivalent of a trust." Furthermore, the petitioner alleges that the *Clifford* Doctrine is applicable even though Judge Magruder in *U. S. v. Morss*, 1 Cir., 159 Fed. 2d 142, 143, 146, pointed out that such doctrine applies only where the retained property rights coincide substantially "with the normal concept of full ownership," and where the rights given away are "insignificant."

We contend that the *Clifford* Doctrine cannot be enlarged and extended to cover this case. This is apparent when we weigh both the property rights given to Mrs. Sunnen, and the property rights, if any, retained by Mr. Sunnen.

When the assignments were delivered to Mrs. Sunnen, and Sunnen Products Company received notice thereof, she acquired the following rights: the right to sell, assign, give away, pledge, or otherwise dispose of the royalty contracts—**rights which Mrs. Clifford did not possess** (309 U. S., at page 333)—; the right to cancel the royalty contracts in accordance with their terms; the right, with the consent of Sunnen Products Company, to alter or amend the royalty contracts so as to provide for greater or lesser royalties, payment of minimum royalties, etc.; the right to sue to enforce performance in good faith by Sunnen Products Company of such contracts; and the right to sue for damages for the breach thereof. These rights were substantially the same as the rights of the assignees in *Blair v. Commissioner*, 300 U. S. 5, 13, 14. In addition, Mrs. Sunnen, as bona fide assignee, had the right to claim the protection of the Courts of law and equity against any unauthorized, collusive, or arbitrary action by Mr. Sunnen, as assignor or as majority stockholder of Sunnen Products Company, tending to interfere with, or defeat her rights. 4 *Am. Jur.*, "*Assignments*," Sec. 105, p. 312; 6 *C. J. S.*, s. 96, p. 1152, s. 101, p. 1158. Even the Commissioner's own

Regulation[5] provides that where a transferee of property has such power over the property transferred, the *Clifford* Doctrine imposes ownership, and tax liability, on such transferee. See also *Richardson v. Commissioner*, 2 Cir., 121 Fed. 2d 1, 3, cert. den. 314 U. S. 684; *Jergens v. Commissioner*, 5 Cir., 136 Fed. 2d 497, 498; *Emery v. Commissioner*, 1 Cir., 156 Fed. 2d 728, 730; and *Conant v. Commissioner*, 7 T. C. 453, 461, all holding that transferees having analogous, or even lesser powers, to deal with corpus of the property transferred are to be deemed the substantial owners of such property.[6] It is clear, therefore, that the rights and powers given to Mrs. Sunnen, as assignee, are anything but "insignificant."

And in addition to these rights possessed by Mrs. Sunnen, as assignee, she possessed all rights incident to her ownership of 200 shares of stock of Sunnen Products Company (R. 26). Such rights gave her the power to prevent Mr. Sunnen, as majority stockholder of the company, from taking any steps to force the company to cancel the royalty contracts, and thus lose over one-half of its profitable business.[7]

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5 Regulation 111, Sec. 29.22 (a)-22, 47† CCH Par. 86B:—"Where a person other than the grantor of property transferred in trust has a power exercisable solely by himself to vest the corpus or income therefrom in himself, the income therefrom shall be included in computing the net income of such person."

6 Compare also *Mallinckrodt v. Nunan*, 8 Cir., 146 Fed. 2d 1; *Busch v. Commissioner*, 8 Cir., 148 Fed. 2d 798.

7 (See authorities cited under Subdivision A above.) That income tax liability cannot be predicated upon the power of a majority stockholder was also recognized in the following cases: *Fox v. Commissioner*, supra, where the taxpayer was sole stockholder of the corporation; *Commissioner v. Montgomery*, supra, where the taxpayer was a director, president, and owner of two out of three shares of the voting stock; *Commissioner v. Greenspun*, 5 Cir., 156 Fed. 2d 917, where the taxpayer was sole stockholder and president of the company; *Funk, W. J., v. Commissioner*, supra, where the taxpayer was a director and owned all voting stock; *Wheelock v. Commissioner*, supra, where taxpayer was president and held proxies to vote all stock; *Edward G. Swartz, Inc., v. Commissioner*, supra, where taxpayer owned all except qualifying shares; *Bear Gulch Water Co. v. Commissioner*, 9 Cir., 116 Fed. 2d 975, holding private corporation taxable on its income although all of its stock was held by a tax-exempt State University; and *Moline Properties, Inc., v. Commissioner*, 319 U. S. 436, holding corporation taxable on gains from sales made by it although one man owned all of its stock.

Let us turn now to the powers which petitioner claims that Mr. Sunnen reserved. These are described on pages 17 et seq. of his brief. These powers were all called to the attention of the Circuit Court of Appeals, were evaluated by it, and were held to be too nebulous to justify imposition of income tax liability on Mr. Sunnen.

In addition to the reasons given by the Circuit Court of Appeals for its views, we wish to call attention to the following facts: The royalties paid were 10% of the gross sales. Mrs. Sunnen received, during the five years here involved, over $261,000.00 (R. 30). Gross sales of said machines amounted to over $2,610,000.00. These sales constituted over half of the business of Sunnen Products Company (R. 32). Mr. Sunnen owned 1,780 shares, Mrs. Sunnen owned 200 shares, and others connected with the company owned the balance of 20 shares of the company's stock (R. 26). Consequently, if Mr. Sunnen had attempted to use his voting powers to elect directors committed to a program of cancelling the royalty contracts, he would have harmed himself more than anyone else—would have seriously depreciated the value of his own stock.[8] Therefore, it is not realistic to assume that he would have taken such action. It is not realistic to assume that he would have been willing to thus depreciate the value of the minority stock interests. It is not realistic to assume that he would have thus jeopardized the company's power to pay its debts.[9] It is not realistic to assume that he would have thus destroyed the carefully trained organization which the company had built up.[10] It is not realistic to assume that

8 Similar self-interest prevented application of the *Clifford* doctrine in *Wachovia Bank & Trust Company, Trustee, et al. v. Commissioner*, 3 TCM 595, 601, CCH Decision No. 14,001M, 1944 P-H, TC Memo Decision Par. 44,217; and in *Wheelock v. Commissioner*, 7 T. C. 98, 107. Moreover, for the same reasons, self-interest on the part of Mr. Sunnen would have prevented him from granting licenses to competitors of Sunnen Products Company.

9 See (R. 32) for amount of debts owed by Sunnen Products Company.

10 See (R. 32) for number of employees of Sunnen Products Company.

he would have been willing to thus defraud his wife of the rights which he had given her as assignee, or to assume that she would have agreed to a course of action depriving her of over $261,000.00.

It is no answer to say, as does petitioner, on page 18 of his brief, that cancellation of the royalty contracts would not necessarily have been a fraud on the company, because Mr. Sunnen and the company could then have entered into contracts more favorable to it. Any such substituted contracts, if more favorable to the company, would have clearly defrauded Mrs. Sunnen of her rights as assignee of the original contracts. And we must base this case on what was done, not what might have been done. Nor is the petitioner's case helped by saying that Mrs. Sunnen had no standing to complain of cancellation by the company, since the contracts gave it the right to cancel upon notice. Surely petitioner does not seriously believe that these contract provisions would have prevented Mrs. Sunnen, as assignee and minority stockholder, from objecting to Mr. Sunnen arbitrarily and unfairly doing indirectly through the corporation what he could not do directly, in derogation of the interests of the corporation, its minority stockholders, and its creditors.

Moreover, the petitioner's argument, regarding Mr. Sunnen granting licenses to competitors of Sunnen Products Company, takes the case out of the realm of established fact, and pitches it into the realm of pure speculation. If speculation is in order, we are justified in making the following guesses: Mr. Sunnen would not license any competitor so long as he owned 89% of the stock of Sunnen Products Company. No competitor would pay for a license so long as Mr. Sunnen remained president of Sunnen Products Company. If competition had occurred, it might even have stimulated the employees of

Sunnen Products Company to greater efforts. And in any event, any such scheme of a majority stockholder to thus divert corporate profits into his own pocket would clearly be a fraud on the rights of the minority stockholders of Sunnen Products Company. We say, therefore, that the results claimed by the petitioner do not necessarily follow. We say, too, that this case must be decided upon actual facts affecting the particular property involved and not upon guesses as to what Mr. Sunnen might or might not have done with other property belonging to him.

In effect, the petitioner bases his case on Mr. Sunnen's alleged power to wrongfully misappropriate his wife's money—to do so in violation of all standards of decency and common honesty. Petitioner's argument is substantially the same as that advanced by him in *Commissioner v. Wilcox* (327 U. S. 404, 407), but this Court rejected such argument on the ground that Wilcox had no rightful claim to the funds involved. As the Circuit Court of Appeals said in its decision in the case at bar (R. 97), "Neither the Tax Court nor this Court should base a decision upon conjecture or possible fraud." As the Tax Court said in *Wheelock v. Commissioner*, supra (7 T. C. 98, 107) taxation should be upon a base more stable than power of a taxpayer to sabotage his company, or to make or break the business.[11]

Moreover, we wish to point out that acceptance of Commissioner's views will have far reaching and dangerous consequences. The petitioner says that Mr. Sunnen's power (as majority stockholder, as President, and as owner of property leased to the corporation) to affect the amount of income paid to his wife, is a sufficient basis for requiring him to pay a tax upon that income. But such a holding

11 In *Wheelock v. Commissioner*, supra, the taxpayer was president of an incorporated advertising business, and had power to vote all stock of the company.

would logically require that he be taxed upon all income of the Sunnen Products Company, for he had just as much power over its entire income as he did over the 10% royalties paid by it to Mrs. Sunnen. And to hold him taxable on all of the corporation's income would clearly violate *Moline Properties, Inc., v. Commissioner*, supra, wherein even a sole stockholder was held not taxable upon the income of the corporation. Furthermore, to hold that Mr. Sunnen's alleged power to end his wife's right to receive royalties imposes tax liability upon him, logically requires that every majority stockholder be held taxable for dividends upon callable stock issued by a corporation to parties in no way connected with such majority stockholder, and be held taxable for rent paid by the corporation under cancellable leases held by strangers.

It seems to us, therefore, that petitioner's arguments obviously prove too much. They overlook the substantial adverse interests possessed by Mrs. Sunnen and others similarly situated.[12] They ignore the principle that powers which are not presently exercisable, and may never be capable of being exercised, do not exist[13]—that powers conditioned on acts which one may not be able to perform, are not the equivalent of "unfettered command."[14] They overlooked the fact that powers of control and manage-

12 An adverse interest is no less adverse because held by one's wife. Her identity cannot be merged with that of her husband. The history of divorce courts, and the modern tendency toward recognition of separate legal rights in wives, opposes such an approach. *Wheelock v. Commissioner*, supra. See also *Commissioner v. Branch*, 1 Cir., 114 Fed. 2d 985, 987, pointing out that the Clifford Doctrine does not obliterate the separate legal personality of a wife; and *Backus, Est. of Standish, v. Commissioner*, 6 TC 1036, 1046, CCH Decision No. 15,142, holding that a husband is not the alter ego of his wife. The presence of adverse interests prevented application of the Clifford Doctrine in *Commissioner v. Betts*, 7 Cir., 123 Fed. 2d 534, 537-540; and *Commissioner v. Katz*, 7 Cir., 139 Fed. 2d 107, 110. Compare also *Reinecke v. Northern Trust Co.*, 278 U. S. 339, 346, holding that power to revoke a trust, with consent of a person having an adverse interest, does not prevent the immediate shifting of economic benefits.

13 *Corning v Commissioner*, 6 Cir., 104 Fed. 2d 329, 332, citing 1 Sugden on Powers, 3d Am. Ed. 371, 372.

14 *Shanley v. Bowers*, 2 Cir., 81 Fed. 2d 13, 15.

ment, no matter how unlimited and absolute they may be, are not a sufficient basis for imposition of tax liability, unless the possessor could derive economic gain from the exercise thereof. This proposition was clearly stated in *Commissioner v. Wilcox*, supra.[15]

In addition, it is not reasonable, just, or expedient to the government, to impose income taxes upon Mr. Sunnen in respect of income which he can never use to pay such taxes. Such taxation violates the principle that graduated income taxes should be levied according to ability to pay. Such taxation violates *Hooper v. Tax Commission*, 284 U. S. 206, 215, holding it unconstitutional to tax one person upon the income of another. And, such taxation seriously jeopardizes the Government's ability to collect its taxes (especially when tax rates reach 91%)—a matter which is just as important as the proper assessment of taxes. No doubt these considerations cause Congress to refuse to tax husband and wife as one, though urged to do so.[16] No doubt these considerations caused Congress to refuse to make the family the taxable unit, and caused it to permit a taxpayer to minimize his taxes by making gifts of income-producing property to others, including members of his family.[17]

For these reasons, we submit that the rights and powers acquired by Mrs. Sunnen were of far greater magnitude

15 See also *Jones v. Norris*, 10 Cir., 122 Fed. 2d 6, 11; *Commissioner v. Betts*, 7 Cir., 123 Fed. 2d 534, 537; *Cushman v. Commissioner*, 2 Cir., 153 Fed. 2d 510, 513, 514. Compare the following cases where the Clifford Doctrine was not applied despite broad powers of control and management possessed by settlor: *Commissioner v. Branch*, 1 Cir., 114 Fed. 2d 985, 987; and *Suhr v. Commissioner*, 6 Cir., 126 Fed. 2d 283, 287.

16 See Revenue Bill of 1941, H. R. 5417, as introduced, 77th Cong., First Session, Sec. 111; H. Rep. No. 1040, 77th Cong., First Session, p. 10, Cong. Rec., Vol. 87, Part 6, pp. 6727-6732; "Mandatory Joint Returns," Joint Committee on Internal Revenue Taxation, U. S. Government Printing Office, 1941.

17 *U. S. v. Morss*, 159 Fed. 2d 142, 143.

than those possessed by her husband, that he cannot fairly be treated as the full owner of property which his wife could freely sell or otherwise dispose of, and that *Helvering v. Clifford*, supra, is not controlling. Every possible argument for using that case to justify taxing Mr. Sunnen upon these royalties, can be repeated with greater force and effect to justify taxing such income to Mrs. Sunnen.

D. **Earned Income.**

As pointed out above, the petitioner contends that Mr. Sunnen's patents were the ultimate source of the royalty income. However, he apparently also contends that these royalties were income earned by Mr. Sunnen, for on page 19 of his brief he cites *Lucas v. Earl*, 281 U. S. 111; *Commissioner v. Tower*, 327 U. S. 280, and *Lusthaus v. Commissioner*, 327 U. S. 293. These contentions are inconsistent.

Moreover, any claim that these royalties constitute earned income of Mr. Sunnen is obviously absurd. The royalties were part of the income earned by Sunnen Products Company, which supplies the labor and capital necessary to manufacture and sell the grinding machines—a fact always recognized by the petitioner when requiring Sunnen Products Company to pay a tax upon its income. Customers of Sunnen Products Company bought and paid for grinding machines, not service rendered by Mr. Sunnen.

These facts were recognized by the Board of Tax Appeals in Mr. Sunnen's prior case (R. 59, 60), and *Lucas v. Earl*, supra, was distinguished (R. 58).

Lucas v. Earl, supra, was also urged upon the Circuit Court of Appeals in the case at bar, but that court ignored it (R. 95).

Commissioner v. Tower, supra, is also distinguishable. Therein the evidence amply supported the Tax Court's holding that the income was in fact earned by the husband (*Commissioner v. Tower*, 327 U. S. 280, 284, 292).[18] Moreover, the Tower case is distinguishable on the ground that Mr. Tower never executed a completed gift of property to his wife (*Commissioner v. Tower*, 327 U. S. 280, 283), whereas in the case at bar the validity of Mr. Sunnen's gift is not attacked.

Nor is *Lusthaus v. Commissioner*, supra, controlling in the case at bar. In the first place, it involves principles of partnership law not applicable to our case. Moreover, the Lusthaus case involves factual determination by the Tax Court — the creation of a bona fide partnership — whereas our case involves a clear failure to apply fundamental legal principles.[19] In addition, while it may be reasonable and just to treat Mr. Lusthaus as substantially the owner of his wife's partnership interest, because she could not dispose of that interest without his consent (327 U. S., at page 296), it is not reasonable and just to treat Mr. Sunnen as substantially the owner of the royalty contracts which Mrs. Sunnen could freely sell, pledge, give away, or otherwise dispose of. Furthermore, we respectfully submit that the views expressed by Mr. Justice Reed,

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18 That *Commissioner v. Tower*, supra, applies primarily to cases of income earned by the personal efforts of the taxpayer, and not to income produced by property of another, is shown by: (a) *Canfield, C. L., v. Commissioner*, 7 T. C. 944, decided Oct. 11, 1946, acquiesced I. R. B. 1947-2, p. 1 (C. C. H. Decisions No. 15414); and (b) I. T. 3845, Par. 3 (b), 1947-7-12515 (p. 2), 474 C. C. H. Par. 6140, p. 10189. Cf. *Schreiber v. Commissioner*, 6 T. C. 707 (C. C. H. Decisions No. 15076), holding that wives were taxable upon rents received by them from a partnership, of which they were limited partners and their husbands were general and managing partners, for the use by the partnership of a building which had been purchased by the wives with their respective shares of the partnership profits. The Circuit Court of Appeals of the 6th Circuit affirmed this decision, *Schreiber v. Commissioner*, 160 Fed. 2d 108, stating that the Tax Court's decision conformed to the principles announced in *Commissioner v. Tower*, supra, and *Lusthaus v. Commissioner*, supra.

19 Our argument on this point is fully explained on p. 23 et seq. of Respondent's brief in opposition to petition for certiorari.

and approved by the Chief Justice, in the Lusthaus case[20], apply with greater force in our case because we are concerned with a gift valid beyond all question, and with income produced exclusively by property and not in large part by the personal efforts of one individual.

E. Term of Royalty Contracts.

In several places in petitioner's brief he emphasizes the fact that the royalty agreements were for periods of ten years.[21] This is done to cause this court to believe that Mr. Sunnen entered into a "short-term" arrangement similar in nature to the "short-term" family trust involved in the Clifford case. But the word "short" is relative. A trust for ten years may be for a short term because it could conceivably last for the lives of one or more persons. But ten years is not a short period in the seventeen-year life of a patent, especially when much of that seventeen-year period must be spent in making and perfecting the product, and creating a demand for it. Then, too, it often happens during such seventeen-year period that consumer demand is satisfied, or that a better product is made and marketed by others, or that infringement suits are brought and won

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20 See dissenting opinion in *Lusthaus v. Commissioner*, supra, rendered by Mr. Justice Reed, and joined in by the Chief Justice (327 U. S., at pages 297-304). *It should be noted, too, that while Mr. Lusthaus could undoubtedly have cancelled the partnership agreement by withdrawing from the partnership at will, could have entered into competing partnerships, could have insisted on bringing in new partners, or taken other steps affecting his wife's partnership income—all of which would have been similar in nature to the alleged powers of Mr. Sunnen so strongly stressed by petitioner in his brief—Mr. Justice Reed pointed out* (327 U. S., at page 303) *that "management of a business which involves only the risk of the capital of another is not the control to which the Clifford case refers."* Moreover, we also wish to point out that failure of the Sunnen royalty agreements to require payment of minimum royalties, a fact stressed by petitioner on page 18 of his brief, should be accorded no more importance than failure of the Lusthaus partnership agreement to require fixed payment to the partners, since it must be presumed that both agreements would, and could be required to be, performed in good faith.

21 For the sake of accuracy it should be noted that the renewal cylinder-grinder agreement was executed on January 10, 1938 and expired with the patent on December 4, 1951 (R. 28).

by others. We say, therefore, as did the Circuit Court of Appeals in the case at bar (R. 98-99), that these royalty contracts were not short-term arrangements, that their term does not affect the validity of the assignments as gifts, that their term is immaterial because no tax evasion motive can be shown, and that to hold otherwise requires repudiating or ignoring the fundamental law of assignments set forth above.

In addition, we wish to point out, as did the Board of Tax Appeals in regard to the assigned oil and gas leases involved in *Ray v. Commissioner*,[22] that these royalty agreements were wasting assets; that consequently as time expired, a period for exploitation was used, and was lost to all persons forever; and that the Clifford doctrine, which involves a temporary reallocation of family income, cannot be given effect in a situation which is not temporary because property rights are consumed, and can never revert to the grantor.[23]

F. **Dobson v. Commissioner**, 320 U. S. 489.

On page 22 of his brief petitioner now concedes that it is unnecessary to determine whether the decision of the Circuit Court of Appeals in the case at bar violated *Dobson v. Commissioner*, supra. Because of this concession it seems unnecessary for us to discuss the matter further. However, we do desire to point out that it seems inconsistent to prevent review of a Tax Court decision, under the ruling of the Dobson case, when the Tax Court's decision is diametrically opposed to a previous decision of the Board of Tax Appeals.

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22 *Ray, Rose L., v. Commissioner*, B. T. A. Memo. Decision Docket No. 101315, decided June 26, 1941, 1941 P-H, B. T. A. Memo Decisions para. 41325, C. C. H., B. T. A. Decisions No. 11874-a.

23 It should be noted, too, as evidence of Mr. Sunnen's intent to make "long-term" arrangements during the useful and productive life of the patents, that when the first cylinder grinder royalty agreement expired on January 10, 1938, it was immediately renewed for the life of the patent, and by Mr. Sunnen assigned to his wife (R. 28).

II.

THE DOCTRINE OF RES JUDICATA OR THE DOCTRINE OF STARE DECISIS SHOULD BE APPLIED.

A. 1937 Cylinder Grinder Royalties.

On page 26 of his brief petitioner says, "none of the royalty contracts and assignments now before the court were involved in the earlier case." This statement, which apparently forms the basis of petitioner's extended argument on the subject, is contrary to the stipulated facts (R. p. 27, par. 7; p. 30, par. 17).

The truth of the matter is that in 1937, one of the years here involved, Sunnen Products Company paid Mrs. Sunnen cylinder grinder royalties of $4,881.35 under the original cylinder-grinder royalty contract. This contract was executed on January 10, 1928; was assigned by Mr. Sunnen to his wife by writings dated January 8, 1929 and December 21, 1931, and expired on January 10, 1938. Royalties payable in previous years under the same identical written instruments were involved in Mr. Sunnen's prior case.

As to these royalties, both the Tax Court (R. 69-70) and the Circuit Court of Appeals (R. 99-100) held that the doctrine of res judicata is applicable.[24]

The petitioner, however, contends that such application of the doctrine of res judicata is erroneous. This is so, he claims, because in the interval between the two Sunnen decisions this court announced new principles of law in *Helvering v. Clifford*, supra; *Helvering v. Horst*, 311 U. S. 112; *Helvering v. Eubank*, 311 U. S. 122, and *Harrison v.*

[24] The Tax Court said (R. 70) that there was complete identity of issues and parties.

Schaffner, 312 U. S. 579. But the petitioner has not shown that such new principles of law have any application whatsoever to our case.

On the other hand, we have, we believe, shown that the Clifford case does not impose tax liability on Mr. Sunnen and that it enunciates no new principles regarding control applicable to him which were not fully expounded in *Corliss v. Bowers*, 281 U. S. 376, which was distinguished by the Board of Tax Appeals in Mr. Sunnen's prior case (R. 60). Nor do the Horst, Eubank and Schaffner cases impugn the principle, relied on in Mr. Sunnen's first case, that the owner of property is taxable upon the income produced thereby. This is clearly pointed out in *Pearce v. Commissioner*, 315 U. S. 543, 554, where this court said that the Horst, Eubank and Schaffner cases involved only assignments of income from property, and that the taxpayer had parted with no substantial interest in the property itself. Likewise, in *Helvering v. Stuart*, 317 U. S. 154, 168, this court said that in the Horst, Eubank and Schaffner cases the taxpayer had not really disposed of the res which produced the income.

Under these circumstances, we deny that any new legal principles, **applicable to the case at bar**, have intervened between the two Sunnen decisions.

B. **Other Royalties.**

In regard to the balance of the royalties paid to Mrs. Sunnen, under contracts not directly involved in Mr. Sunnen's prior case, the Tax Court held that the doctrine of res judicata was not applicable (R. 71). The Circuit Court of Appeals, in view of its decision for Mr. Sunnen on the merits, found it unnecessary to decide whether the doctrine of res judicata, or the doctrine of stare decisis, was

applicable, but did point out that the parties and the questions involved were the same in both of Mr. Sunnen's cases (R. 100-101). Such being the case, we contend that the doctrine of res judicata, or the more elastic doctrine of stare decisis,[25] is applicable.

In *Commissioner v. Montgomery*, supra, the Circuit Court of Appeals of the Fifth Circuit held that Montgomery was not the owner of profits from a construction contract assigned by him to his corporation. Despite this decision the Commissioner contended in *Montgomery v. Thomas*, supra, that Montgomery was the owner of income earned by the corporation on this contract and subsequently paid by it as dividends on stock owned by the Montgomery children. Nevertheless, the court applied the doctrine of res judicata, saying:

> "This court, in Commissioner v. Montgomery, considered and established the legality of the corporation and to whom its earnings belonged, and by whom the tax on its earnings was due. These questions were settled in that litigation between the same parties who are litigants here" (146 Fed. 2d, at page 79).

Likewise, we say that Mr. Sunnen's prior case established the separate entity of Sunnen Products Company, to whom its earnings belonged, and by whom the tax on such earnings is due. The case at bar merely represents a second attempt to have the courts again consider the same question. See, also, *City of Aurora v. West*, 74 U. S. (7 Wall.) 82, in which the Supreme Court said: "Where the parties are the same, the legal effect of the former judgment as a bar is not impaired, because the subject matter of the second suit is different, provided the second

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[25] See *Paul*, "*Selected Studies in Federal Taxation*," 2d Series, pp. 118, 119, pointing out that although these two doctrines are similar in some respects, the doctrine of stare decisis is more elastic and offers a binding rule of precedent in matters of law. See further 21 *Corpus Juris Secundum*, p. 305, and 14 American Jurisprudence, p. 283.

suit involves the same title, and depends upon the same questions." In *Last Chance Mining Company v. Tyler Mining Company*, 157 U. S. 683, 691, this court said: "The essence of the estoppel by judgment is that there has been a judicial determination of a fact, and the question always is, has there been such a determination, and not upon what evidence * * * it was reached." This language, and the statement made in *American Law Institute "Restatement of the Law—Judgments,"* p. 299, "Taxes," are particularly pertinent in connection with the factual determination, made in Mr. Sunnen's prior case, that the royalty contract constituted the income-producing property.

In addition we wish to point out that the doctrine of stare decisis applies even though the facts involved in the later case are not exactly the same as in the prior one. Thus in *Northwestern Mutual Life Ins. Co. v. Wright et al.*, 153 Wisc. 252, 140 N. W. 1078, American Annotated Cases 1914 D, pages 697, 699, 700, it is said:

> "An examination of the authorities cited by counsel for appellants does not enable us to find anything therein particularly out of harmony with the foregoing. In no one of them are the facts the same as those here, and, if there be anything said in any of them out of harmony with the principles stated, the principles, not the adjudication, must prevail. Every essential to a transfer of title, according to the terms of the assignment, is shown.
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> * * * * * * *
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> "It is quite useless to point out distinctions between a case in hand and previous adjudications here or elsewhere, there being no distinction in principle. The keynote of an adjudication is the ruling principle. The details showing the particular facts ruled by some particular principle are helpful; but in the end, it is the principle, not the detail circumstances, commonly evidentiary only, which is the important feature as to

whether an existing adjudication is a safe guide to follow in a case, presently. Mere details may widely vary, as indicated in the cases cited, yet the ruling principle be the same * * *."

See, also, *American Mutual Liability Ins. Co. of Boston v. Duesenberg*, 14 N. E. 2d 919, 16 N. E. 2d 698, 117 A. L. R. 1293, 1297, in which the Indiana Supreme Court said: "* * * but in the consideration of precedents courts do not look so much for identity of facts as for statements of applicable principles."

Consequently, we contend that, from the point of view of Mr. Sunnen's liability for income taxes on these royalties, there is no distinction in principle between this case and the prior case. Only some of the paper evidence is different.

III.

THE PETITIONER DID NOT ASSESS THE DEFICIENCIES FOR 1937 AND 1938 WITHIN THE TIME PRESCRIBED BY LAW.

On this point we concede that the deficiencies for 1937 and 1938 were assessed within due time by the Petitioner if this court should determine that he has borne the burden of proving that the royalties paid to Mrs. Sunnen in those years were owned by, and taxable to, Mr. Sunnen. We desire only to point out that the burden of proof in 1937 and 1938 is upon the Petitioner, because he is seeking to take advantage of the five-year limitation period mentioned in Sec. 275 (c) of the Revenue Acts of 1936 and 1938, 26 U. S. C. A., "Internal Revenue Acts," pp. 919, 1108. That the Commissioner must carry such burden of proof was established by *Easton v. Commissioner*, T. C. Memo. Op. Dkt. No. 110974, entered 2/5/43, 1 T. C. M. par. 12,963M, 1943 P-H T. C. Memo. Dec. Par. 43,063; *Burrows v. Com-*

missioner, T. C. Memo. Dec. Dkt. No. 109537, entered 6/30/43, 2 T. C. M. par. 13,350M, 1943 P-H T. C. Memo. Dec. Par. 43338; and *Reis v. Commissioner,* 1 T. C. 9.

Moreover, we contend that the Commissioner has not met the burden of proof placed upon him—has not established that said royalties were taxable to Joseph Sunnen; and that, consequently, his deficiency assessments for 1937 and 1938 are void because made after the time prescribed by Sec. 275 (a) of the Revenue Acts of 1936 and 1938.

Of course, if this court should hold that none of said royalties are taxable to Mr. Sunnen, then this question of limitation need not be passed upon.

CONCLUSION.

Based on these authorities we contend, on the first issue, that as Joseph Sunnen assigned to his wife the property which produced this income, he is not taxable thereon; that to tax him on it is to measure his income tax liability by the income of another, which is unconstitutional; that to tax him on it is to overlook the fact that he had no claim to such income, and could derive no gain, profit, or benefit therefrom; that he cannot be considered the virtual owner of said property, and of said income, under the Clifford doctrine, by merging his identity with that of Sunnen Products Company, or by merging his identity with that of Mrs. Sunnen; and that if the Commissioner's extension of the Clifford doctrine has any application to this case, it requires taxation of this income to Mrs. Sunnen, who had very important and substantial rights of ownership, and not to Mr. Sunnen, who had only an indirect, and legally nonexistent, power over Sunnen Products Company.

On the second issue, we believe that the decision in Mr. Sunnen's prior case barred the present deficiency assess-

ments, since that case held that he did not own the income, or the property which produced it.

And on the third issue, we contend that unless this court should determine that the Commissioner has borne the burden of proving that Mr. Sunnen was taxable upon the 1937 and 1938 royalties, the assessment of the deficiencies for such years was made after the expiration of the applicable statutes of limitation.

Respectfully submitted,

C. POWELL FORDYCE,
Attorney for Respondent.

APPENDIX.

Internal Revenue Act 1936:

Sec. 275. **Period of Limitation Upon Assessment and Collection.**

(a) **General rule.**—The amount of income taxes imposed by this title shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

Internal Revenue Act 1938:

Sec. 275. **Period of Limitation Upon Assessment and Collection.**

(a) **General rule.**—The amount of income taxes imposed by this title shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

Internal Revenue Act of 1936:

Sec. 275. **Period of Limitation Upon Assessment and Collection.**

(c) **Omission from gross income.**—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed.

Internal Revenue Act of 1938:

Sec. 275. **Period of Limitation Upon Assessment and Collection.**

(c) **Omission from gross income.**—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed.

SUPREME COURT OF THE UNITED STATES

No. 227.—October Term, 1947.

Commissioner of Internal Revenue, Petitioner, v. Joseph Sunnen.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

[April 5, 1948.]

Mr. Justice Murphy delivered the opinion of the Court.

The problem of the federal income tax consequences of intra-family assignments of income is brought into focus again by this case.

The stipulated facts concern the taxable years 1937 to 1941, inclusive, and may be summarized as follows:

The respondent taxpayer was an inventor-patentee and the president of the Sunnen Products Company, a corporation engaged in the manufacture and sale of patented grinding machines and other tools. He held 89% or 1,780 out of a total of 2,000 shares of the outstanding stock of the corporation. His wife held 200 shares, the vice-president held 18 shares and two others connected with the corporation held one share each. The corporation's board of directors consisted of five members, including the taxpayer and his wife. This board was elected annually by the stockholders. A vote of three directors was required to take binding action.

The taxpayer had entered into several non-exclusive agreements whereby the corporation was licensed to manufacture and sell various devices on which he had applied

for patents.[1] In return, the corporation agreed to pay to the taxpayer a royalty equal to 10% of the gross sales price of the devices. These agreements did not require the corporation to manufacture and sell any particular number of devices; nor did they specify a minimum amount of royalties. Each party had the right to cancel the licenses, without liability, by giving the other party written notice of either six months or a year.[2] In the absence of cancellation, the agreements were to continue in force for ten years. The board of directors authorized the corporation to execute each of these contracts. No notices of cancellation were given. Two of the agreements were in effect throughout the taxable years 1937-1941, while the other two were in existence at all pertinent times after June 20, 1939.

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[1] The various devices involved were as follows:

(1) A cylinder grinder. The taxpayer applied for a patent on Nov. 17, 1927, and was issued one on Dec. 4, 1934. The royalty agreement to manufacture and sell this device was dated Jan. 10, 1928. This agreement expired on Jan. 10, 1938; a renewal agreement in substantially the same terms was then executed for the balance of the life of the patent, which ends on Dec. 4, 1951.

(2) A pinhole grinder. The taxpayer applied for a patent on Dec. 4, 1931, and was issued one on June 13, 1933. The royalty agreement to manufacture and sell this device was dated Dec. 5, 1931.

(3) A crankshaft grinder. The taxpayer applied for a patent on May 22, 1939, and was issued one on May 6, 1941. The royalty agreement to manufacture and sell this device was dated June 20, 1939.

(4) Another crankshaft grinder. The taxpayer applied for a patent on Dec. 29, 1939. He assigned this application to his wife on Dec. 29, 1942, and she was issued a patent on Jan. 26, 1943. The royalty agreement to manufacture and sell this device was dated June 20, 1939.

The taxpayer remained the owner of the first three patents throughout the year 1941, and he remained the owner of the patent application on the fourth device throughout that year.

[2] Six months' notice was provided in the agreement dated Jan. 10, 1928, covering the cylinder grinder. The other three agreements provided for one year's notice of cancellation.

The taxpayer at various times assigned to his wife all his right, title and interest in the various license contracts.[3] She was given exclusive title and power over the royalties accruing under these contracts. All the assignments were without consideration and were made as gifts to the wife, those occurring after 1932 being reported by the taxpayer for gift tax purposes. The corporation was notified of each assignment.

In 1937 the corporation, pursuant to this arrangement, paid the wife royalties in the amount of $4,881.35 on the license contract made in 1928; no other royalties on that contract were paid during the taxable years in question. The wife received royalties from other contracts totaling $15,518.68 in 1937, $17,318.80 in 1938, $25,243.77 in 1939, $50,492.50 in 1940, and $149,002.78 in 1941. She included all these payments in her income tax returns for those years, and the taxes she paid thereon have not been refunded.

Relying upon its own prior decision in *Estate of Dodson* v. *Commissioner*, 1 T. C. 416,[4] the Tax Court held that,

[3] On Jan. 8, 1929, the taxpayer assigned to his wife "all my rights, title and interest in and to the Royalty which shall accrue hereafter to me" upon the royalty contract of Jan. 10, 1928, with respect to the cylinder grinder device. Since the Commissioner of Internal Revenue raised some question as to the sufficiency and completeness of this assignment, the taxpayer executed a further assignment on Dec. 21, 1931. This second assignment confirmed the first one and stated further that his wife was assigned "all of my right, title and interest in and to said royalty contract of January 10, 1928 . . . . And I hereby state that the royalties accruing under said royalty contract have heretofore been and are hereafter the sole and exclusive property of the said Cornelia Sunnen [his wife], and hereby declare that said royalties shall be paid to the said Cornelia Sunnen or to her order, and that she shall have the sole right to collect, receive, receipt for, retain or sue for said royalties."

Assignments similar in form and substance to the assignment of Dec. 21, 1931, were made as to the other three royalty contracts.

[4] In the *Dodson* case, Dodson owned 51% of the stock of a corporation and his wife owned the other 49%. He was the owner of a

with one exception, all the royalties paid to the wife from 1937 to 1941 were part of the taxable income of the taxpayer. 6 T. C. 431. The one exception concerned the royalties of $4,881.35 paid in 1937 under the 1928 agreement. In an earlier proceeding in 1935, the Board of Tax Appeals dealt with the taxpayer's income tax liability for the years 1929–1931; it concluded that he was not taxable on the royalties paid to his wife during those years under the 1928 license agreement. This prior determination by the Board caused the Tax Court to apply the principle of *res judicata* to bar a different result as to the royalties paid pursuant to the same agreement during 1937.

The Tax Court's decision was affirmed in part and reversed in part by the Eighth Circuit Court of Appeals. 161 F. 2d 171. Approval was given to the Tax Court's application of the *res judicata* doctrine to exclude from the taxpayer's income the $4,881.35 in royalties paid in 1937 under the 1928 agreement. But to the extent that the taxpayer had been held taxable on royalties paid to his wife during the taxable years of 1937–1941, the decision was reversed on the theory that such payments were not income to him. Because of that conclusion, the Circuit Court of Appeals found it unnecessary to decide the taxpayer's additional claim that the *res judicata* doctrine applied as well to the other royalties (those accruing apart from the 1928 agreement) paid in the taxable years. We then brought the case here on certiorari, the Commis-

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formula and trade mark. Pursuant to a contract which he made with the corporation, the corporation was given the exclusive use of the formula and trade mark for 5 years, renewable for a like period. Dodson was to receive in return a royalty measured by a certain percentage of the net sales. He then assigned a one-half interest in the contract to his wife, retaining his full interest in the formula and trade mark. The Tax Court held that his dominant stock position permitted him to cancel or modify the contract at any time, thus rendering him taxable on the income flowing from his wife's share in the contract.

sioner alleging that the result below conflicts with prior decisions of this Court.

If the doctrine of *res judicata* is properly applicable so that all the royalty payments made during 1937–1941 are governed by the prior decision of the Board of Tax Appeals, the case may be disposed of without reaching the merits of the controversy. We accordingly cast our attention initially on that possibility, one that has been explored by the Tax Court and that has been fully argued by the parties before us.

It is first necessary to understand something of the recognized meaning and scope of *res judicata*, a doctrine judicial in origin. The general rule of *res judicata* applies to repetitious suits involving the same cause of action. It rests upon considerations of economy of judicial time and public policy favoring the establishment of certainty in legal relations. The rule provides that when a court of competent jurisdiction has entered a final judgment on the merits of a cause of action, the parties to the suit and their privies are thereafter bound "not only as to every matter which was offered and received to sustain or defeat the claim or demand, but as to any other admissible matter which might have been offered for that purpose." *Cromwell* v. *County of Sac*, 94 U. S. 351, 352. The judgment puts an end to the cause of action, which cannot again be brought into litigation between the parties upon any ground whatever, absent fraud or some other factor invalidating the judgment. See von Moschzisker, "Res Judicata," 38 Yale L. J. 299; Restatement of the Law of Judgments, §§ 47, 48.

But where the second action between the same parties is upon a different cause or demand, the principle of *res judicata* is applied much more narrowly. In this situation, the judgment in the prior action operates as an estoppel, not as to matters which might have been litigated and determined, but "only as to those matters

in issue or points controverted, upon the determination of which the finding or verdict was rendered." *Cromwell* v. *County of Sac, supra,* 353. And see *Russell* v. *Place,* 94 U. S. 606; *Southern Pacific R. Co.* v. *United States,* 168 U. S. 1, 48; *Mercoid Corp.* v. *Mid-Continent Co.,* 320 U. S. 661, 671. Since the cause of action involved in the second proceeding is not swallowed by the judgment in the prior suit, the parties are free to litigate points which were not at issue in the first proceeding, even though such points might have been tendered and decided at that time. But matters which were actually litigated and determined in the first proceeding cannot later be relitigated. Once a party has fought out a matter in litigation with the other party, he cannot later renew that duel. In this sense, *res judicata* is usually and more accurately referred to as estoppel by judgment, or collateral estoppel. See Restatement of the Law of Judgments, §§ 68, 69, 70; Scott, "Collateral Estoppel by Judgment," 56 Harv. L. Rev. 1.

These same concepts are applicable in the federal income tax field. Income taxes are levied on an annual basis. Each year is the origin of a new liability and of a separate cause of action. Thus if a claim of liability or non-liability relating to a particular tax year is litigated, a judgment on the merits is *res judicata* as to any subsequent proceeding involving the same claim and the same tax year. But if the later proceeding is concerned with a similar or unlike claim relating to a different tax year, the prior judgment acts as a collateral estoppel only as to those matters in the second proceeding which were actually presented and determined in the first suit. Collateral estoppel operates, in other words, to relieve the government and the taxpayer of "redundant litigation of the identical question of the statute's application to the taxpayer's status." *Tait* v. *Western Md. R. Co.,* 289 U. S. 620, 624.

But collateral estoppel is a doctrine capable of being applied so as to avoid an undue disparity in the impact of income tax liability. A taxpayer may secure a judicial determination of a particular tax matter, a matter which may recur without substantial variation for some years thereafter. But a subsequent modification of the significant facts or a change or development in the controlling legal principles may make that determination obsolete or erroneous, at least for future purposes. If such a determination is then perpetuated each succeeding year as to the taxpayer involved in the original litigation, he is accorded a tax treatment different from that given to other taxpayers of the same class. As a result, there are inequalities in the administration of the revenue laws, discriminatory distinctions in tax liability, and a fertile basis for litigious confusion. Compare *United States* v. *Stone & Downer Co.*, 274 U. S. 225, 235–236. Such consequences, however, are neither necessitated nor justified by the principle of collateral estoppel. That principle is designed to prevent repetitious lawsuits over matters which have once been decided and which have remained substantially static, factually and legally. It is not meant to create vested rights in decisions that have become obsolete or erroneous with time, thereby causing inequities among taxpayers.

And so where two cases involve income taxes in different taxable years, collateral estoppel must be used with its limitations carefully in mind so as to avoid injustice. It must be confined to situations where the matter raised in the second suit is identical in all respects with that decided in the first proceeding and where the controlling facts and applicable legal rules remain unchanged. *Tait* v. *Western Md. R. Co.*, *supra*. If the legal matters determined in the earlier case differ from those raised in the second case, collateral estoppel has no bearing on the situation. See *Travelers Ins. Co.* v. *Commissioner*,

161 F. 2d 93. And where the situation is vitally altered between the time of the first judgment and the second, the prior determination is not conclusive. See *State Farm Ins. Co.* v. *Duel*, 324 U. S. 154, 162; 2 Freeman on Judgments (5th ed. 1925) § 713. As demonstrated by *Blair* v. *Commissioner*, 300 U. S. 5, 9, a judicial declaration intervening between the two proceedings may so change the legal atmosphere as to render the rule of collateral estoppel inapplicable.[5] But the intervening decision need not necessarily be that of a state court, as it was in the *Blair* case. While such a state court decision may be considered as having changed the facts for federal tax litigation purposes, a modification or growth in legal principles as enunciated in intervening decisions of this Court may also effect a significant change in the situation. Tax inequality can result as readily from neglecting legal modulations by this Court as from disregarding factual changes wrought by state courts. In either event, the supervening decision cannot justly be ignored by blind reliance upon the rule of collateral estoppel. *Henricksen* v. *Seward*, 135 F. 2d 986, 988–989; *Pelham Hall Co.* v. *Hassett*, 147 F. 2d 63, 68–69; *Commissioner* v. *Arundel-Brooks Concrete Corp.*, 152 F. 2d 225, 227; *Corrigan* v. *Commissioner*, 155 F. 2d 164, 165; and see *West Coast Life Ins. Co.* v. *Merced Irr. Dist.*, 114 F. 2d 654, 661–662; contra: *Commissioner* v. *Western Union Tel. Co.*, 141 F. 2d 774, 778. It naturally follows that an interposed alteration in the pertinent statutory provisions or Treasury regulations can make the use of

[5] See also *Henricksen* v. *Seward*, 135 F. 2d 986; *Monteith Bros. Co.* v. *United States*, 142 F. 2d 139; *Pelham Hall Co.* v. *Hassett*, 147 F. 2d 63; *Commissioner* v. *Arundel-Brooks Concrete Corp.*, 152 F. 2d 225; *Corrigan* v. *Commissioner*, 155 F. 2d 164. Compare *Grandview Dairy* v. *Jones*, 157 F. 2d 5.

that rule unwarranted. *Tait* v. *Western Md. R. Co.*, *supra*, 625.[6]

Of course, where a question of fact essential to the judgment is actually litigated and determined in the first tax proceeding, the parties are bound by that determination in a subsequent proceeding even though the cause of action is different. See *The Evergreens* v. *Nunan*, 141 F. 2d 927. And if the very same facts and no others are involved in the second case, a case relating to a different tax year, the prior judgment will be conclusive as to the same legal issues which appear, assuming no intervening doctrinal change. But if the relevant facts in the two cases are separable even though they be similar or identical, collateral estoppel does not govern the legal issues which recur in the second case.[7] Thus the second proceeding may involve an instrument or transaction identical with, but in a form separable from, the one dealt with in the first proceeding. In that situation, a court is free in the second proceeding to make an independent examination of the legal matters at issue. It may then reach a different result or, if consistency in decision is considered just and desirable, reliance may be placed upon the ordinary rule of *stare decisis*. Before a party can invoke the collateral estoppel doctrine in these circumstances, the legal matter raised in the second proceeding must involve the same set of events or documents and the same bundle of legal principles that contributed to the rendering of the first judgment. *Tait* v. *Western Md. R. Co.*, *supra*. And see Griswold, "Res Judicata in Federal Tax Cases," 46 Yale L. J. 1320;

[6] And see *Commissioner* v. *Security-First Nat. Bank*, 148 F. 2d 937.

[7] *Stoddard* v. *Commissioner*, 141 F. 2d 76, 80; *Campana Corporation* v. *Harrison*, 135 F. 2d 334; *Engineer's Club of Philadelphia* v. *United States*, 42 F. Supp. 182.

Paul and Zimet, "Res Judicata in Federal Taxation," appearing in Paul, Selected Studies in Federal Taxation (2d series, 1938), p. 104.

It is readily apparent in this case that the royalty payments growing out of the license contracts which were not involved in the earlier action before the Board of Tax Appeals and which concerned different tax years are free from the effects of the collateral estoppel doctrine. That is true even though those contracts are identical in all important respects with the 1928 contract, the only one that was before the Board, and even though the issue as to those contracts is the same as that raised by the 1928 contract. For income tax purposes, what is decided as to one contract is not conclusive as to any other contract which is not then in issue, however similar or identical it may be. In this respect, the instant case thus differs vitally from *Tait* v. *Western Md. R. Co., supra,* where the two proceedings involved the same instruments and the same surrounding facts.

A more difficult problem is posed as to the $4,881.35 in royalties paid to the taxpayer's wife in 1937 under the 1928 contract. Here there is complete identity of facts, issues and parties as between the earlier Board proceeding and the instant one. The Commissioner claims, however, that legal principles developed in various intervening decisions of this Court have made plain the error of the Board's conclusion in the earlier proceeding, thus creating a situation like that involved in *Blair* v. *Commissioner, supra.* This change in the legal picture is said to have been brought about by such cases as *Helvering* v. *Clifford,* 309 U. S. 331; *Helvering* v. *Horst,* 311 U. S. 112; *Helvering* v. *Eubank,* 311 U. S. 122; *Harrison* v. *Schaffner,* 312 U. S. 579; *Commissioner* v. *Tower,* 327 U. S. 280; and *Lusthaus* v. *Commissioner,* 327 U. S. 293. These cases all imposed income tax liability on transferors who had assigned or transferred various forms of income

to others within their family groups, although none specifically related to the assignment of patent license contracts between members of the same family. It must therefore be determined whether this *Clifford-Horst* line of cases represents an intervening legal development which is pertinent to the problem raised by the assignment of the 1928 agreement and which makes manifest the error of the result reached in 1935 by the Board. If that is the situation, the doctrine of collateral estoppel becomes inapplicable. A different result is then permissible as to the royalties paid in 1937 under the agreement in question. But to determine whether the *Clifford-Horst* series of cases has such an effect on the instant proceeding necessarily requires inquiry into the merits of the controversy growing out of the various contract assignments from the taxpayer to his wife. To that controversy we now turn.[8]

Had the taxpayer retained the various license contracts and assigned to his wife the right to receive the royalty payments accruing thereunder, such payments would clearly have been taxable income to him. It has long

[8] The pertinent statutory provisions are of little help to the matter in issue. Section 22 (a) of the Revenue Act of 1936, 49 Stat. 1648, and § 22 (a) of the Revenue Act of 1938, 52 Stat. 447, cover the taxable years in question. Those sections, which are identical with the current § 22 (a) of the Internal Revenue Code, define "gross income" to include "gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or for gains or profits and income derived from any source whatever." See also Art. 22 (a)–1 of Treasury Regulations 94, promulgated under the 1936 Act; Art. 22 (a)–1 of Treasury Regulations 101, promulgated under the 1938 Act; and § 19.22 (a)–1 of Treasury Regulations 103, promulgated under the Internal Revenue Code.

been established that the mere assignment of the right to receive income is not enough to insulate the assignor from income tax liability. *Lucas* v. *Earl*, 281 U. S. 111; *Burnet* v. *Leininger*, 285 U. S. 136. As long as the assignor actually earns the income or is otherwise the source of the right to receive and enjoy the income, he remains taxable. The problem here is whether any different result follows because the taxpayer assigned the underlying contracts to his wife in addition to giving her the right to receive the royalty payments.

It is the taxpayer's contention that the license contracts rather than the patents and the patent applications were the ultimate source of the royalty payments and constituted income-producing property, the assignment of which freed the taxpayer from further income tax liability. We deem it unnecessary, however, to meet that contention in this case. It is not enough to trace income to the property which is its true source, a matter which may become more metaphysical than legal. Nor is the tax problem with which we are concerned necessarily answered by the fact that such property, if it can be properly identified, has been assigned. The crucial question remains whether the assignor retains sufficient power and control over the assigned property or over receipt of the income to make it reasonable to treat him as the recipient of the income for tax purposes. As was said in *Corliss* v. *Bowers*, 281 U. S. 376, 378, "taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed—the actual benefit for which the tax is paid."

It is in the realm of intra-family assignments and transfers that the *Clifford-Horst* line of cases has peculiar applicability. While specifically relating to short-term family trusts, the *Clifford* case makes clear that where the parties to a transfer are members of the same family group, special scrutiny is necessary "lest what is in reality but one economic unit be multiplied into two or more by

devices which, though valid under state law, are not conclusive so far as § 22 (a) is concerned." 309 U. S. at 335. That decision points out various kinds of documented and direct benefits which, if retained by the transferor of property, may cause him to remain taxable on the income therefrom. And it also recognizes that the fact that the parties are intimately related, causing the income to remain within the family group, may make the transfer give rise to informal and indirect benefits to the transferor so as to make it even more clear that it is just to tax him. Even more directly pertinent, however, is the *Horst* case, together with the accompanying *Eubank* case. See 2 Mertens, Law of Federal Income Taxation (1942), §§ 18.02, 18.14. It was there held that the control of the receipt of income, which causes an assignor of property to remain taxable, is not limited to situations where the assignee's realization of income depends upon the future rendition of services by the assignor. See *Lucas* v. *Earl, supra; Burnet* v. *Leininger, supra.* Such may also be the case where the assignor controls the receipt of income through acts or services preceding the transfer. Or it may be evidenced by the possibility of some subsequent act by the assignor, or some failure to act, causing the income or property to revert to him. Moreover, the *Horst* case recognizes that the assignor may realize income if he controls the disposition of that which he could have received himself and diverts payment from himself to the assignee as a means of procuring the satisfaction of his wants, the receipt of income by the assignee merely being the fruition of the assignor's economic gain.

In *Harrison* v. *Schaffner, supra,* 582, it was again emphasized that "one vested with the right to receive income did not escape the tax by any kind of anticipatory arrangement, however skillfully devised, by which he procures payment of it to another, since, by the exercise of his power to command the income, he enjoys the benefit of the income on which the tax is laid." And it was also

noted that "Even though the gift of income be in form accomplished by the temporary disposition of the donor's property which produces the income, the donor retaining every other substantial interest in it, we have not allowed the form to obscure the reality." 312 U. S. at 583. *Commissioner* v. *Tower, supra,* and its companion case, *Lusthaus* v. *Commissioner, supra,* reiterated the various principles laid down in the earlier decisions and applied them to income arising from family partnerships.

The principles which have thus been recognized and developed by the *Clifford* and *Horst* cases, and those following them, are directly applicable to the transfer of patent license contracts between members of the same family. They are guideposts for those who seek to determine in a particular instance whether such an assignor retains sufficient control over the assigned contracts or over the receipt of income by the assignee to make it fair to impose income tax liability on him.

Moreover, the clarification and growth of these principles through the *Clifford-Horst* line of cases constitute, in our opinion, a sufficient change in the legal climate to render inapplicable, in the instant proceeding, the doctrine of collateral estoppel relative to the assignment of the 1928 contract. True, these cases did not originate the concept that an assignor is taxable if he retains control over the assigned property or power to defeat the receipt of income by the assignee. But they gave much added emphasis and substance to that concept, making it more suited to meet the "attenuated subtleties" created by taxpayers. So substantial was the amplification of this concept as to justify a reconsideration of earlier Tax Court decisions reached without the benefit of the expanded notions, decisions which are now sought to be perpetuated regardless of their present correctness. Thus in the earlier litigation in 1935, the Board of Tax Appeals was unable to bring to bear on the assignment of the

1928 contract the full breadth of the ideas enunciated in the *Clifford-Horst* series of cases. And, as we shall see, a proper application of the principles as there developed might well have produced a different result, such as was reached by the Tax Court in this case in regard to the assignments of the other contracts. Under those circumstances collateral estoppel should not have been used by the Tax Court in the instant proceeding to perpetuate the 1935 viewpoint of the assignment.

The initial determination of whether the assignment of the various contracts rendered the taxpayer immune from income tax liability was one to be made by the Tax Court. That is the agency designated by law to find and examine the facts and to draw conclusions as to whether a particular assignment left the assignor with substantial control over the assigned property, or the income which accrues to the assignee. And it is well established that its decision is to be respected on appeal if firmly grounded in the evidence and if consistent with the law. *Commissioner* v. *Scottish American Co.*, 323 U. S. 119; *Dobson* v. *Commissioner*, 320 U. S. 489. That is the standard, therefore, for measuring the propriety of the Tax Court's decision on the merits of the controversy in this case.

The facts relative to the assignments of the contracts are undisputed. As to the legal foundation of the Tax Court's judgment on the tax consequences of the assignments, we are unable to say that its inferences and conclusions from those facts are unreasonable in the light of the pertinent statutory or administrative provisions or that they are inconsistent with any of the principles enunciated in the *Clifford-Horst* line of cases. Indeed, due regard for those principles leads one inescapably to the Tax Court's result. The taxpayer's purported assignment to his wife of the various license contracts may properly be said to have left him with something more

than a memory. He retained very substantial interests in the contracts themselves, as well as power to control the payment of royalties to his wife, thereby satisfying the various criteria of taxability set forth in the *Clifford-Horst* group of cases. That fact is demonstrated by the following considerations:

(1) As president, director and owner of 89% of the stock of the corporation, the taxpayer remained in a position to exercise extensive control over the license contracts after assigning them to his wife. The contracts all provided that either party might cancel without liability upon giving the required notice. This gave the taxpayer, in his dominant position in the corporation, power to procure the cancellation of the contracts in their entirety. That power was nonetheless substantial because the taxpayer had but one of the three directors' votes necessary to sanction such action by the corporation. Should a majority of the directors prove unamenable to his desires, the frustration would last no longer than the date of the next annual election of directors by the stockholders, an election which the taxpayer could control by reason of his extensive stock holdings. The wife, as assignee and as a party to contracts expressly terminable by the corporation without liability, could not prevent cancellation provided that the necessary notice was given.

And it is not necessary to assume that such cancellation would amount to a fraud on the corporation, a fraud which could be enjoined or otherwise prevented. Cancellation conceivably could occur because the taxpayer and his corporation were ready to make new license contracts on terms more favorable to the corporation, in which case no fraud would necessarily be present. All that we are concerned with here is the power to procure cancellation, not with the possibility that such power might be abused. And once it is evident that such power exists, the conclusion is unavoidable that the taxpayer retained a sub-

stantial interest in the license contracts which he assigned.

(2) The taxpayer's controlling position in the corporation also permitted him to regulate the amount of royalties payable to his wife. The contracts specified no minimum royalties and did not bind the corporation to manufacture and sell any particular number of devices. Hence, by controlling the production and sales policies of the corporation, the taxpayer was able to increase or lower the royalties; or he could stop those royalties completely by eliminating the manufacture of the devices covered by the royalties without cancelling the contracts.

(3) The taxpayer remained the owner of the patents and the patent applications. Since the licenses which he gave the corporation were non-exclusive in nature, there was nothing to prevent him from licensing other firms to exploit his patents, thereby diverting some or all of the royalties from his wife.

(4) There is absent any indication that the transfer of the contracts effected any substantial change in the taxpayer's economic status. Despite the assignments, the license contracts and the royalty payments accruing thereunder remained within the taxpayer's intimate family group. He was able to enjoy, at least indirectly, the benefits received by his wife. And when that fact is added to the legal controls which he retained over the contracts and the royalties, it can fairly be said that the taxpayer retained the substance of all the rights which he had prior to the assignments. See *Helvering* v. *Clifford*, *supra*, 335–336.

These factors make reasonable the Tax Court's conclusion that the assignments of the license contracts merely involved a transfer of the right to receive income rather than a complete disposition of all the taxpayer's interest in the contracts and the royalties. The existence

of the taxpayer's power to terminate those contracts and to regulate the amount of the royalties rendered ineffective for tax purposes his attempt to dispose of the contracts and royalties. The transactions were simply a reallocation of income within the family group, a reallocation which did not shift the incidence of income tax liability.

The judgment below must therefore be reversed and the case remanded for such further proceedings as may be necessary in light of this opinion.

Reversed.

MR. JUSTICE FRANKFURTER and MR. JUSTICE JACKSON believe the judgment of the Tax Court is based on substantial evidence and is consistent with the law, and would affirm that judgment for reasons stated in *Dobson* v. *Commissioner*, 320 U. S. 489, and *Commissioner* v. *Scottish American Co.*, 323 U. S. 119.